S. HRG. 113–328

REAUTHORIZING TRIA: THE STATE OF THE TERRORISM RISK INSURANCE MARKET, PART II

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED THIRTEENTH CONGRESS

SECOND SESSION

ON

CONTINUING EXAMINATION OF THE NEED TO REAUTHORIZE THE TERRORISM RISK INSURANCE PROGRAM, THE ROLE THAT THE CURRENT PROGRAM PLAYS IN THE MARKET, AND THE PROGRAM'S FEATURES THAT ARE DESIGNED TO PROTECT WORKERS, COMMUNITIES, AND TAXPAYERS

FEBRUARY 25, 2014

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C O N T E N T S

TUESDAY, FEBRUARY 25, 2014

WITNESSES

Additional Material Supplied for the Record

REAUTHORIZING TRIA: THE STATE OF THE TERRORISM RISK INSURANCE MARKET, PART II

TUESDAY, FEBRUARY 25, 2014

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 10:04 a.m., in room SD–538, Dirksen Senate Office Building, Senator Tim Johnson, Chairman of the Committee, presiding.

OPENING STATEMENT OF CHAIRMAN TIM JOHNSON

Chairman JOHNSON. I call this hearing to order.

Today we hold our second hearing on reauthorizing TRIA and the state of the terrorism risk insurance market.

Unfortunately, we have votes scheduled for 11:15.

At our first hearing last fall, we heard testimony from experts who reminded the Committee of the history of this program the need for this program, the extensive layers of taxpayer protections in the program and the role the private market has been able to play because of the existence and structure of the program, not in spite of it.

The Committee was also cautioned that any drastic changes to the program could negatively affect small insurance providers and their policyholders.

As I noted at that hearing, the last time TRIA was reauthorized, Congress made very few changes and extended the program for 7 years. Another long extension will promote economic growth, providing certainty for commercial property development and job creation across the country.

I look forward to hearing from our witnesses today and their views on the issues the Committee needs to consider carefully as we move forward to reauthorize the program.

We also appreciate the important insight others, such as the Big "I," the Financial Services Roundtable and the Reinsurance Association of America, have provided us through written statements and past testimony that we will enter into the record.

There are also a number of our colleagues, on and off the Committee, on both sides of the aisle, who are leaders on this issue. I would like especially to thank Senators Reed, Menendez, Schumer, Tester, Warner, Murphy, Klobuchar and Franken on my side of the aisle and Senators Kirk, Heller and Blunt on Ranking Member Crapo's side.

I look forward to continue working with Ranking Member Crapo and our colleagues to move forward with a bill to extend TRIA in short order.

I turn to Ranking Member Crapo for his opening statement.

STATEMENT OF SENATOR MIKE CRAPO

Senator CRAPO. Thank you, Mr. Chairman. I know we are short on time, so I will keep my remarks very briefly.

We have had a lot of analysis of the TRIA program so far. We all know the issues that we are dealing with.

And I am committed to working to help us reauthorize TRIA. We need to, and will, continue to promote private capital ahead of the Government backstop. While changes to the TRIA program levers are necessary, reauthorization gives us the chance to examine other changes that might make the program better.

I am interested in the thoughts of our panel on how to adjusting certification might impact the TRIA program as well as any other areas of reform that the program could benefit from.

Since the last hearing, Chairman Johnson and I and our staffs have continued to work toward developing a bipartisan approach to reauthorizing this program. We both agree that TRIA reauthorization is an important priority for the Committee. I welcome his continued partnership in developing an extension to the program.

In order to limit the economic and physical impact of any future terrorist attack on the United States, we have got to get TRIA right. I am hopeful that today's hearing will help us move our discussions forward as we look forward to a markup.

Chairman JOHNSON. Thank you, Senator Crapo.

Due to votes later this morning, I will ask the other Members to withhold making opening statements if possible and, rather, submit them into the record.

That being said, are there any other Members who would like to give very brief opening statements?

[No response.]

Senator JOHNSON. I would like to remind my colleagues that the record will be open for the next 7 days for additional statements and other materials.

Before we begin, I would like to introduce our witnesses.

Mr. Edward Walter is the President and CEO of Host Hotels and Resorts, testifying on behalf of the Coalition to Insure Against Terrorism.

Ms. Carolyn Snow is the President of the Risk and Insurance Managements Society.

Mr. Bill Henry is the CEO of McQueary, Henry, Bowles and Troy, testifying on behalf of the Council of Insurance Agents and Brokers.

Mr. Vincent Donnelly is the President and CEO of PMA Insurance Group, testifying on behalf of the Property Casualty Insurers Association of America.

Mr. Warren Heck is the CEO and Chairman of the Board of Greater New York Insurance Companies, testifying on behalf of the National Association of Mutual Insurance Companies.

And we are pleased to have our colleague, Senator Murphy, introduce our last witness.

STATEMENT OF CHRISTOPHER MURPHY, A UNITED STATES SENATOR FROM THE STATE OF CONNECTICUT

Senator MURPHY. Thank you very much, Mr. Chairman, and thank you, Ranking Member Crapo, for having me here today.

I know the Senators representing all of the companies here on the panel are proud of their work.

We are especially proud of one of our seminal companies, the Hartford. I am here to introduce Mr. Doug Elliot, who is the President of Commercial Markets with The Hartford Financial Services Group which is based, unsurprisingly, in Hartford, Connecticut.

Mr. Elliot is responsible for The Hartford's small commercial middle market and specialty casualty business as well as group benefits. He has had a long history in Connecticut insurance as President of Hartford Steam Boiler as well as CEO of Travelers's general and commercial lines.

I look forward to his testimony and the wealth of insight and experience that he is going to bring to today's proceedings.

Mr. Chairman, I would just like to note that I believe that we here in Congress have begun, in a way, to tempt fate by waiting as long as we have to reauthorize TRIA. As we all know, TRIA's impending expiration at the year's end has meant that all current TRIA insurance policies now include springing clauses in the event that Congress fails to act.

And, with limited time left in the legislative calendar, I cannot stress the need for haste any more forcefully. Pushing a matter like this into the lame duck session, which a lot of us fear may happen, could do real damage to the property markets.

Lastly, I just want to underscore the fact that while insurers obviously have to administer and bear the risk of TRIA they are not the only face of TRIA policyholders. My State, like every other state, is replete with stadiums and hospitals and malls and other sources of commercial properties that utilize TRIA's unique public-private partnership. They are really the face of the effort to renew this new law.

The real risk of not doing that goes to insurers but also to the millions of property owners who utilize terrorism risk insurance and also to the economic development that simply will not happen without this protection.

So I thank, Mr. Chairman, you and the Committee for taking this issue so seriously.

I would like to submit for the record a statement from my colleague, Senator Blumenthal, and I look forward to today's discussion.

Chairman JOHNSON. Without objection.

Chairman JOHNSON. Before we begin, I will ask the witnesses to try to keep their testimony to 2 minutes, and their full written testimony will be submitted to the record.

Mr. Walter, please proceed.

STATEMENT OF W. EDWARD WALTER, PRESIDENT, CHIEF EXECUTIVE OFFICER AND DIRECTOR, HOST HOTELS & RESORTS, INC., ON BEHALF OF THE COALITION TO INSURE AGAINST TERRORISM

Mr. WALTER. Good morning, Chairman Johnson, Ranking Member Crapo and Members of the Committee.

My name is Ed Walter, and I am the President and CEO of Host Hotels and Resorts. Host owns, or has interest in, hotel properties in 15 countries and 24 States and is one of the largest owners of hotels in the world.

I am testifying today on behalf of the Coalition to Insure Against Terrorism, or CIAT. CIAT is a broad coalition of commercial insurance consumers formed after the September 11, 2011 attacks, to ensure that American businesses could obtain adequate terrorism insurance.

I urge Congress to act now to extend TRIA well before its expiration at year-end. Without adequate terrorism insurance, our economy, our jobs and our well-being become more vulnerable to terrorism. Maintaining a workable Federal terrorism insurance mechanism is vital for our Nation's economic security.

My own company was deeply and personally affected by the terrorist acts of September 11th. Host lost the Marriott World Trade Center Hotel, which was destroyed by the collapse of the two World Trade Center Towers, and our Marriott New York Financial Center Hotel located two blocks away was also heavily damaged. More importantly, we suffered the loss of two hotel employees.

For those of us that had commercial policies in place on 9/11, the financial loss suffered as a result of the attack were covered by insurance, but all this changed after September 11th. The uncertainty surrounding the future of terrorism insurance contributed significantly to a paralysis in the economy, particularly in the construction, tourism, business travel and real estate finance areas.

We are concerned that if TRIA is not extended that we run multiple risks. We are concerned that we will see a slowing in construction; we will see a slowing in real estate finance; we will see a slowing in the creation of jobs. We run the risk of lender-instigated defaults because if companies cannot provide terrorism insurance they will be in violation of their loan covenants.

So, finishing my remarks, I guess what I would just say is we have a program that shares risk equitably across all the players. The Government only steps in at the very end. It is a program that works. It is a program that encourages investment in the United States.

We run a risk of short-circuiting what is already a relatively weak recovery if we do not renew this and renew this soon.

Thank you.

Chairman JOHNSON. Thank you.

Ms. Snow, please proceed.

STATEMENT OF CAROLYN SNOW, DIRECTOR, RISK MANAGEMENT, HUMANA INC., ON BEHALF OF RISK AND INSURANCE MANAGEMENT SOCIETY, INC.

Ms. SNOW. Good morning, Chairman Johnson, Ranking Member Crapo and Members of the Committee.

My name is Carolyn Snow, and I am Director of Risk Management for Humana, Inc. based on Louisville, Kentucky, and the President of Risk and Insurance Management Society, RIMS, on behalf of whom I am testifying today. We are a not-for-profit largest group of risk management professionals, and we represent the commercial insurance consumer.

Availability and affordability of coverage for acts of terrorism is not only an insurance issue; it is an economic one.

Nine-eleven proved that the private market alone is not sufficient, and the creation of TRIA in 2002 brought stability to the market situation by providing a backstop for some of the risk that the Federal Government helped free up capacity in the private market.

The availability of adequate coverage is directly linked to the existence of TRIA. If it were allowed to expire, carriers will look to reduce their exposure, particularly in high threat areas.

Our members are already reporting on mandatory requirements of sunset clauses in policies that extend beyond December 31, 2014. Some policyholders are being offered standalone policies for the policies extending beyond but with high deductibles and premiums that are nonrefundable should TRIA be reauthorized at a later date.

The impact on worker's compensation is already being felt as some companies concentrated in major urban areas are seeing price increases of 5 to 10 percent in their premiums.

We have heard comments that there may be sufficient capital in the private insurance market to provide terrorism insurance, but we question whether that capital would actually be used for terrorism coverage as the industry still does not have the capability to properly underwrite terrorism.

There is no assurance that terrorism insurance would be made available to all entities that need it at affordable prices.

We also recommend streamlining the certification process but consolidating the decisionmaking authority within one office, or department, and recommend a 60-day deadline with the possibility of one extension.

We would also like to see a specific inclusion for nuclear, biological, chemical and radiological events.

In conclusion, we feel very strongly that a public and private partnership provides the best alternative to addressing the long-term needs of availability and affordability of terrorism insurance.

Further, we believe that having TRIA as a Federal backstop, not a bailout, will be better protection of the taxpayers' money.

On behalf of RIMS, thank you for the opportunity to speak.

Chairman JOHNSON. Thank you.

Mr. Henry, please proceed.

STATEMENT OF BILL HENRY, CEO, McQUEARY, HENRY, BOWLES AND TROY, INC., ON BEHALF OF THE COUNCIL OF INSURANCE AGENTS & BROKERS

Mr. HENRY. Mr. Chairman, Ranking Member Crapo and Committee Members, I am Bill Henry, CEO of MHBT, and I testify today on behalf of the Council of Insurance Agents and Brokers but, most importantly, on behalf of my customers.

MHBT is one of the largest privately held insurance brokers in Texas with 5 offices and 315 employees.

The Council represents all the major agents and brokers in the country and represents over 80 percent of the commercial placements of insurance in this country.

Gentlemen, nobody is closer to this issue than agents and brokers. We are dealing with all the carriers every day, and we are dealing with the customers.

I saw firsthand what happened after 9/11, and it was not pretty. It is not just a big-city issue. It is not just a property issue.

Worker's compensation is a bigger issue. Under comp, you cannot exclude terrorism. So what basically happens is the insurance industry begins to underwrite more strictly and people with more than 50 employees end up with no coverage or in an assigned risk pool.

I expect more of the same in the future if TRIA is not extended or if it is amended in a major way.

I can tell you I am a capitalist through and through, but this is a societal issue. It is not just an insurance industry issue. The capital at stake already by our industry requires the CEO of an insurance company to risk 20 percent of their premium each year as a trigger, and in addition to that they get back 85 cents on the dollar if there is loss, and then after that they have to repay it.

We need a vibrant insurance industry in this country. And if we kill the carriers with too much burden, then we end up with the small guys pulling out, the middle-size guys not wanting to play and redirecting their underwriting, and the larger guys charging higher prices.

Thank you very much.

Chairman JOHNSON. Thank you.

Mr. Donnelly, please proceed.

STATEMENT OF VINCENT T. DONNELLY, PRESIDENT AND CEO, PMA INSURANCE GROUP, ON BEHALF OF THE PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA

Mr. DONNELLY. Thank you, Chairman Johnson and Ranking Member Crapo, for inviting me to testify today.

My name is Vincent Donnelly, and I am the President and CEO of the PMA Insurance Group. I am testifying on behalf of PMA and the Property Casualty Insurers Association of America, PCI.

PMA specializes in the writing of worker's compensation insurance, providing wage replacement and medical and debt benefit to employees injured in the course of their employment.

Reauthorization of TRIA is critical to our business and to our customers. The private insurance and reinsurance markets are not willing to accept every risk, particularly unpredictable and potentially catastrophic risks like terrorism. Having a terrorism risk insurance plan in place before the next attack happens protects our companies, our country's economic resiliency, at nearly no cost to the taxpayers.

PMI and PCA strongly urge you to enact a long-term reauthorization of the current working version of TRIA.

It is appropriate for Congress to ask whether the current plan is serving its intended purpose or whether additional reforms should be considered, but TRIA has done a superb job of bringing private capital that would not otherwise be available into the market to support terrorism risk. Government involvement occurs only at the most extreme levels.

So PCI hopes that the Committee will recognize TRIA's enormous success in providing fiscally responsible terrorism risk coverage to protect our countries economy while greatly reducing the need for Government assistance after a catastrophic terrorist attack.

Following 9/11, reinsurance coverage for terrorism became very difficult to obtain, especially for high-profile risk and risk in regions with high-valued accumulations with a potential for nuclear, biological, chemical and radiological attacks.

If TRIA were not reauthorized, that would happen again. This would cause some insurance capital to flee critical markets, and it would result in availability and affordability problems for vulnerable businesses, and the scale of losses could impair worker's compensation insurers' ability to pay the claims of injured workers.

Many of the reforms now being discussed to increase private sector participation would weaken the loss limits for insurers. That would reduce the willingness of private capital to invest in, or to cover, terrorism risk. Let me explain why, briefly.

Every insurer limits its risk to an exposure it can responsibly manage and still fulfill its commitments to all policyholders. If TRIA is reauthorized with a higher trigger, deductible or co-share, insurers would be left with risk that exceeds levels that they could not retain and many could be driven out of markets. The current deductible already leaves many insurers with a large potential loss than they would ever voluntarily accept.

The same is true with the co-insurance. The current trigger is greater than most of the surplus of many of the TRIA insurers.

Small- and medium-size insurers make up 98 percent of the companies writing TRIA coverage, and they are the most vulnerable to being driven out of the markets by increases in the TRIA thresholds. If that happens, it would reduce insurance availability and greatly reduce competition for consumers.

So, in conclusion, that is why PMA and PCI strongly support long-term authorization of TRIA in its current from.

I thank you for the opportunity to testify and look forward to answering your questions.

Chairman JOHNSON. Thank you.

Mr. Heck, please proceed.

STATEMENT OF WARREN W. HECK, CEO AND CHAIRMAN OF THE BOARD, GREATER NEW YORK INSURANCE COMPANIES, ON BEHALF OF THE NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES

Mr. HECK. Thank you, Chairman Johnson, Ranking Member Crapo and Members of the Committee for this opportunity to speak to you today.

My name is Warren Heck, and I am Chairman and CEO of Greater New York Mutual Insurance Companies, a mid-size but significant piece of the commercial multi-peril insurance market in New York, and we have been doing that for 100 years.

I also serve as Chairman of the National Association of Mutual Insurance Companies' TRIA task force. NAMIC represents more than 1,400 property and casualty insurance companies, including small farm mutuals, State and regional insurance carriers and large national riders. NAMIC members write half of all personal property and casualty lines and about a third of the commercial business in the United States.

Today, the terrorism insurance market is functioning extremely well. Coverage is available and affordable. A limited amount of reinsurance is available, and take-up rates average 60 percent or more across the country. There are few, if any, demonstrable market failure problems.

It is our firm belief, which has been tested by the market after 9/11, that in the absence of TRIA an adequate self-sustaining private market for terrorism risk insurance will not develop because the unique nature of terrorism distinguishes it from natural catastrophes and makes it virtually impossible to properly underwrite.

But as TRIA's successful history has demonstrated, the program allows a viable market to function, which will help insure resiliency before and after a terrorist event, all while protecting taxpayers.

NAMIC remains committed to ensuring that the program adequately protects taxpayers and maximizes private sector capital in the market for terrorism insurance. We believe the current program does an excellent job on both counts.

Because the markets are functioning efficiently, we would urge caution when considering changes. For example, raising the $100 million dollar trigger would do nothing to improve the program or reduce taxpayer exposure while, at the same time, putting pressure on smaller, regional and niche insurers whose deductible and even total exposure falls under a level set too low. Too high, excuse me.

This type of change will cause market participants to exit just as they did in New York City after 9/11, thereby reducing available capacity and concentrating the risk with fewer insurance carriers. Any effective terrorism loss management plan depends upon participation by insurers of all sizes and structures.

Rather than focus on changing parts of the program that seem to be working well, we would encourage the Committee to consider reforming the certification process to include some sort of a timeline and requirement for an affirmative determination. Our experience with the tragic Boston Marathon bombing demonstrates the need for such a change.

In order to encourage private sector involvement in the terrorism insurance marketplace and, thereby, protect and promote our Nation's finances, security and economic strength, we should maintain a long-term well-functioning terrorism loss management plan. Fortunately, the current TRIA program has proven to be just such a plan.

Thank you for the opportunity to speak here today, and I look forward to answering any questions you may have.

Chairman JOHNSON. Thank you.

Mr. Elliot, please proceed.

STATEMENT OF DOUGLAS G. ELLIOT, PRESIDENT, COMMERCIAL MARKETS, THE HARTFORD FINANCIAL SERVICES GROUP, ON BEHALF OF THE AMERICAN INSURANCE ASSOCIATION

Mr. ELLIOT. Good morning. Chairman Johnson, Ranking Member Crapo and Members of the Committee, thank you for the opportunity today to appear here.

My name is Doug Elliot, and I am President of Commercial Markets at The Hartford. I am testifying today on behalf of the American Insurance Association.

We strongly urge Congress to reauthorize TRIA before it expires at the end of this year. TRIA is designed to protect the economy from disruptions caused by catastrophic terrorism, and taxpayers are protected at every step under TRIA's recoupment mechanism.

As we approach TRIA's expiration, we understand the focus on increasing private market capacity, but the industry's ability to take on more terrorism risk is constrained. We run the risk that, at some point, manipulating the program's levers will result in a tipping point that could cause individual insurers to curtail their aggregate exposure in an effort to maintain their respective companies' finances.

If this occurs, it could cause a severe and immediate disruption to the economy, reduce the supply of affordable terrorism coverage and undercut the ability of businesses, both large and small, to rebound from future terrorist attacks.

We look forward to working with the Committee, and I look forward to your questions this morning.

Thank you.

Chairman JOHNSON. Thank you all very much for your testimony.

As we begin questions, I will ask the clerk to put 5 minutes on the clock for each Member.

As we look to move a reauthorization bill soon, I would like to ask the entire panel, should we make the extension for a long period like Congress did last time in 2007?

Mr. Walter, let's begin with you and go down the table.

Mr. WALTER. Senator, I would think that a 7-year extension would probably be the minimum that we should consider, and it would be better if we were to consider a longer period of time.

For those of us in the real estate industry, we are typically making investments where we are looking at 7 to 10 to 15 or longer timeframes.

When we invest in Europe and some other markets around the world, one of the issues we do not have to worry about is how this issue will be dealt with because they have permanent programs.

In the United States, we have not necessarily had the benefit, certainly so far, of a permanent program. But having something that would be longer-term, that would allow us to know that for the period of financing or for the period of ownership that we might have in that particular investment, that this issue would be covered by the TRIA program would be advantageous. And I think it would encourage incremental real estate investment.

Chairman JOHNSON. Thank you.

Ms. Snow.

Ms. SNOW. On behalf of the RIMS members, we would like to see a permanent program. By the minimum, we would like to see a 10-year extension.

Chairman JOHNSON. Mr. Henry.

Mr. HENRY. Senator, basically, the independent agents and the Council agents would love to see this become permanent.

It is an extremely uninsurable risk. It is not going to change over the next 5 or 10 years. We will still have the same problem at that time. So this is a permanent problem, and we would like to see a permanent solution.

Thank you, sir.

Chairman JOHNSON. Mr. Donnelly.

Mr. DONNELLY. Senator, I agree with the comments that my colleagues at the table have made already, that permanent certainly would be the optimal way.

The fact that the risk—even 11 years, 12 years after 9/11, one of the things that has not changed is that this terrorism is not an insurable risk in a traditional way, in terms of being able to measure or calculate with any reasonable certainty what the probability of loss is or the size of loss and the fact that the loss is not random but is an intentional act.

So the longer the better, and I would agree that somewhere in 7 to 10 years is sort of a minimum that would be appropriate for the industry as well as for the economy to maintain stability so that insurers, as they deploy capital, have a level of certainty to give to their customers.

Chairman JOHNSON. Mr. Heck.

Mr. HECK. I think a permanent program would be the best way to protect the taxpayers and the economy.

Seven years ago, I recall that many people argued that TRIA should be temporary. However, since then, we have learned that terrorism is not going away anytime soon.

However, so long as terrorism remains a threat to the United States, we need to continue TRIA to protect the country.

Chairman JOHNSON. Mr. Elliot.

Mr. ELLIOT. Mr. Chairman, I would also agree that we would look for a permanent solution. Other than that, I would suggest that 10 years would be a minimum requirement for us to start discussion.

Chairman JOHNSON. Mr. Henry and Mr. Elliot, we have heard that if Congress were to drastically raise the threshold in the program there could be a negative impact in smaller insurance providers and policyholders.

Mr. Henry, do you share this concern, and if so, why?

Mr. HENRY. I just simply think that a lot of the smaller insurance carriers are at risk even as we speak with the thresholds where they are. And, if you change the thresholds, then I think they are going to be even more restrictive on their underwriting and they will pull back from any possible threat if they possibly can, which ends up meaning a smaller market and higher prices.

Chairman JOHNSON. Mr. Elliot, what do you think?

Mr. ELLIOT. Mr. Chairman, the issue of the trigger is important to many of our member companies.

As I sit here representing The Hartford, it is not the same issue. Our retention currently under today's program is $1.2 billion, and the trigger is only $100 million. So it is really not the same issue for our company.

Chairman JOHNSON. Senator Crapo.

Senator CRAPO. Thank you, Mr. Chairman.

Mr. Donnelly, in your testimony, you mentioned the current interpretation with respect to nuclear, biological, chemical and radiological risks and that the TRIA backstop covers losses to the extent insurers provide the coverage. Are you comfortable with that interpretation?

Mr. DONNELLY. Well, I think that, Senator, certainly for worker's compensation, NBCR is covered because there is no exclusion with respect to any peril for comp. So I am comfortable that from a worker's compensation perspective that is clear.

But I do think the language should be looked at, and I know that PCI has provided some language changes to clarify that, to make sure that it is clear how the TRIA would respond relative to how the NBCR or even cyber risk could come into play.

Senator CRAPO. Well, you just led into my next question, and that is let's talk about that. In the past several years, we have become more aware of the threat that cyber attacks present to our economy, and there is no question that a cyber attack could cause significant damage.

And, on this question, I would like to have any of the other Members of the panel who would like to comment on it comment as well.

What would be the impact of clarifying TRIA coverage of cyber events, and should only those events with property damage be covered?

Mr. Donnelly, why don't you start out? But, I would like to hear the impressions of others.

Mr. DONNELLY. Senator, I think to the extent that the underlying policies for nonterrorism coverage of cyber risk, certainly, the terrorism then would be covered and TRIA should properly respond to that.

But I do not think there should be a mandatory requirement for insurers for liability policies, for example, to cover cyber attacks. I mean, that is something that I think should be left up to the individual insured and insurer in terms of deciding what risk they exactly want to underwrite and what kind of coverage they want.

Mr. HECK. May I respond?

Senator CRAPO. Mr. Heck.

Mr. HECK. With respect to NBCR, the current property policies have a very good exclusion for NBCR. So, if NBCR is not covered under TRIA, it would not be covered.

And NBCR, frankly, is uninsurable. So it is not something that I believe that we should try to alter.

I certainly agree with regard to worker's comp, but it is already picked up by the program because it cannot be excluded under worker's comp.

With respect to cyber, I think that is a different issue, and I think that under the same reasoning the cyber would be covered so long as it is covered in the underlying policy.

So I really do not believe anything more needs to be done with either of those issues.

Senator CRAPO. Mr. Elliot.

Mr. ELLIOT. Senator Crapo, just a few comments.

The first thing I would say is the bill today provides Treasury the ability to go in and delineate, or more clearly articulate, some of the regulations, and I know they did that in 2004 for some of the NBCR coverages. So I would expect over time we may see that with cyber.

I would share with you from a risk perspective. It clearly is an emerging area. We are studying it intently. The breadth of cyber spans things from our national grid to malware to credit losses, *et cetera.* And I think we are all learning as time goes on here, and we will learn more over the coming quarters.

Senator CRAPO. Thank you.

Yes, Mr. Walter.

Mr. WALTER. Senator, the biggest benefit, or one of the largest benefits, that we see from TRIA is the fact that it provides a road map and solution for how to deal with a potential problem.

The cyber area is one that is developing quickly. I do not think any of us fully understand exactly how those sorts of incidents would play out. But the reality is that including that in some fashion within TRIA would make sense to me because I think it also then provides a way to plan for a recovery in the event of a problem down the road.

And I think we are far better off trying to anticipate some of those types of problems as opposed to dealing with them in the aftermath.

Senator CRAPO. Thank you.

Anybody else?

[No response.]

Senator CRAPO. All right. Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Tester.

Senator TESTER. Yes, thank you, Mr. Chairman, and I want to thank all the participants for their testimony today.

I will direct this at you, Mr. Elliot, but any of you feel free to respond. Could you elaborate on how this program puts private capital in front of Federal dollars?

Mr. ELLIOT. Having been involved with the original design of the program 12 years ago and understanding what that marketplace was like, post-9/11, I think that the program today sets the foundation for private capital and private exposure to come into the insurance marketplace. And I think it has done largely what we had hoped it would do 12 years ago. We have made some adjustments over time, but I am very pleased that it has allowed companies, such as ourselves and our member companies, to provide an awful lot of exposure and insurance coverage to the economy.

Senator TESTER. OK. Anybody else want to respond to that?

Go ahead.

Mr. HECK. Yes, I would like to add to that that the whole design of the TRIA program was to improve capacity to write terrorism insurance, and I really think that it has been one of the most successful of the Government private-public programs in that all participants can participate so long as the triggers, the deductibles and the co-insurance levels do not increase too much.

If they do go up, particularly the trigger, it will push out the small- and medium-size companies, and that will reduce the amount of capacity.

So I truly hope that we can renew the program without changes.

Senator TESTER. OK. Go ahead.

Mr. DONNELLY. I echo Mr. Heck's comments in terms of stressing the importance that the current program allows a really cross-section of small, medium and large insurers to participate in this.

If there, in fact, were changes to the trigger or the deductible or the co-insurance, that would have the effect, I believe, of reducing the amount of private capital that would be in it.

Not only has—for two reasons I say that.

One is for the fact that each company has to make their own capital decisions in terms of how much they are going to allocate for any particular risk. And so as the potential exposure would grow, companies, I believe—including my company, I think—would think about how much capital are we willing to risk for any one exposure.

The second element is A.M. Best, which is the credit rating agency for all insurance companies, I think has already made comments—public comments—about that the absence of reauthorization in its form would have a significant impact on many small- and medium-size insurers in terms of looking at their ratings.

And it is very, very important in the insurance industry that—what I think Mr. Henry could speak to, as representing the agents and brokers, is the financial ratings of an insurance company are very, very important to compete effectively.

Senator TESTER. OK. So I do not want to put words in your mouth, but what I heard you just say was that if the deductible was raised small companies would leave the market, which I agree with, who write nearly half the policies, and private capital would not come to the marketplace in as large of amounts. Is that correct?

Mr. DONNELLY. I believe that there would be less private capital.

Senator TESTER. So let's take that another step. Thus, if we were to do that, it would put the taxpayers more at risk.

Mr. DONNELLY. I think what it would do is create more of an availability issue and less choices for consumers.

Senator TESTER. OK. And we will go back to another question here that goes back to my original question. If we had no TRIA program, if the TRIA program was not there at all, could you explain what the risk to taxpayers would be then?

Mr. Elliot?

Mr. ELLIOT. In the absence of a TRIA program, a backstop, I think we would have a shortage of insurance available capacity for customers throughout the country, particularly those that have aggregate employee populations together and the worker's comp policy that does not exclude TRIA coverages. We would have to be very selective, guarding our own policyholder surplus and our ratings.

Senator TESTER. And then what would happen?

Go ahead, Mr. Walter.

Mr. WALTER. I think the reality is if you did not have TRIA you would increase the exposure of the Federal Government to pay for those types of events.

Senator TESTER. Why?

Mr. WALTER. Right now, what you have is a program that is designed to first take money from the company that is the insured through the deductible and, second, essentially extract money from the insurance industry by requiring them to provide coverage, and only if you have gone through those two buckets does the Federal Government step in.

In your situation, one exists; two does not, or does not in enough magnitude, to cover the loss or cover the losses to the extent they are covered today, which means that three has to step up. That means the Federal Government is paying more.

Senator TESTER. Thank you for that answer.

Mr. HECK. May I add something?

Senator TESTER. I have only got 9 seconds, so you have got to be quick.

Mr. HECK. OK. I think we already experienced a situation with no TRIA. We had that right after 9/11.

And what happened? Construction came to a halt. Mortgagees would not lend. The economy was impacted significantly.

I think without TRIA the premium for terrorism, the very little terrorism coverage available, can become unaffordable.

Senator TESTER. Good.

Mr. Henry, go ahead. You had your hand up.

Mr. HENRY. Senator, I think the Federal Government would still be on the hook because the insurance carriers are going to deduct those losses over time.

Senator TESTER. Right.

Mr. HENRY. And TRIA or no TRIA, you are going to end up with a very dysfunctional system.

Senator TESTER. And I would just say that increasing the deductibles—I appreciate the answer Mr. Donnelly had on that because we want to get more private capital into the market, not extract it.

I appreciate everything you have said.

I was going to ask about the workmen's comp issue. Mr. Henry, you fleshed it out pretty good in your opening remarks. I very much appreciate it.

We need to get on this as a Committee.

Thank you.

Chairman JOHNSON. Senator Corker.

Senator CORKER. Thank you, Mr. Chairman.

I do want to follow on a little bit with Senator Tester's comment. I think all of us want to make sure that we protect the taxpayers, and so when we look at a program like this, that is obviously what we have an eye toward.

Mr. Heck, you hit at the issue that happened after 9/11, but I think we saw evidence of what happens when you do not have a program like this in place, and that is we, as a Federal Government, wrote a check for $20 billion that we did not recoup.

I mean, that, to me, is the greatest example of how taxpayers are not protected if we do not have a program like this that is designed to recoup the money.

Let me say this one more time. When we have a disaster, Congress responds. A lot of times it does not respond very prudently, I might add. A lot of money goes out the door without it being checked properly. All of us have debated that in recent disasters.

What the TRIA program does is actually create a mechanism to keep us from ever having to do that again. Is that right?

Mr. HECK. Absolutely.

Senator CORKER. So I do want to make that point that this is one of those cases where those of us who are free market folks and, at the same time, want to look at protecting taxpayers do have a mechanism in place that actually does that. OK.

So I think on the other hand we probably want to look at some reforms, right?

I mean, all of us want to make sure that we are looking at this in the right way.

You guys are arguing for a permanent program.

Let me just ask a couple of questions because I know the Ranking Member and Chairman are about to come up with a package soon.

But right now, the Treasury Secretary has to call us for reimbursement if we have losses up to $27.5 billion, but everything above that is at his discretion.

Does it make sense for us to put in there that it is mandatory above—it has to be mandatory for all losses. Is that something that is a sensible reform?

Mr. DONNELLY. Senator, I think that is a reasonable variable to look at in terms of whether increasing that or, as you suggested, permanency to no cap on it or all the way up to the $100 billion cap. I do think that is something that can be looked at as a tweaking, if you will, of the current program.

And I would echo what you said—that this is a very good risk management plan that is in place today. As somebody that is 35 years in the business, we deal about risk with our customers, and you want to have the plan in place before the event happens.

And I think that this particular plan that is in place today is a good one in terms of preparing for, God forbid, an event that may happen.

Senator CORKER. Yes, sir.

Mr. HECK. I would like to suggest that no change is really needed. At the present——

Senator CORKER. I kind of gathered that is the company line today, but I do not think it is going to end up quite that way.

Mr. HECK. I will give you a reason. You know, right now, the Government gets a recoupment at 133 percent for losses of $27.5 billion and below, and the Secretary of the Treasury can recoup up to 100 percent. And I think that would depend upon the state of the economy, whether it is a good idea to do it or not, but the fact is the Secretary has that availability and can do that right now.

Why lock ourselves into something which we would be required to do, and it may not be a good idea at the time of the terrible event?

Mr. ELLIOT. Senator Corker, just if I can add and agree with Mr. Heck, it is our estimation today that the industry deductible retention, if you will, is actually closer to $34 billion than the 27.5 that was initially put in place. And that means that an event would have to exceed 34 for the Government even to be involved.

So I think there is an awful lot of skin in the game from the insurers' side, and I do also agree that there is a terrific balance between a public-private partnership there.

Senator CORKER. Just briefly—and I want to make one statement, so just maybe one person answer.

I know there is an 85–15 share, and I know that there have been comments about maybe changing that to 80–20.

Whichever one of you thinks is the brilliant, if you would answer whether that change would be harmful or something that would actually be useful, I would appreciate it—maybe the man with two first names and that I understand more than anybody else on the Committee.

Mr. HENRY. The Texas twang is alive and well, Senator.

Actually, from a customer standpoint, I would hate to see a tweak like that because after tax you are really probably not going to be putting any more money in the coffers of the Federal Government because, remember, the insurance companies are going to deduct the losses that they have.

Right now, we have got a vibrant insurance market. Things are functioning well. Our customers are happy. The bankers are happy lending money. And I would hate to see it change.

Senator CORKER. Let me just close with this. I know that each of you have weighed in at our offices.

I do want to say to the Chairman; thank you for having the hearing.

Look, we know we are going to extend TRIA. So let's get on with it. I will say that we do a lot around here to hurt our economy. You know, we are kind of like the biggest problem for the economy right now—is Washington.

This is something we know we are going to extend. We have got some major projects that we know are going to be delayed if we do not get on with this, and I think waiting until lame duck is irresponsible.

I hope that we will figure out if there are going to be reforms. Let's discuss them. Let's make them happen.

But, Mr. Chairman, again, thanks for having this hearing. I would say we know what we are going to do. You know, let's just get on with it. OK.

Thank you.

Chairman JOHNSON. Senator Schumer.

Senator SCHUMER. Thank you, and I thank my colleague from Tennessee for those comments. I could not agree more.

I want to thank you, Mr. Chairman, and Senator Crapo for being involved here.

Now following the events of 9/11, the private sector, plain and simple, refused to offer sufficient coverage necessary to protect against the threat of terrorism. They could not account for the unpredictability or assess how great the losses were likely to be.

Fortunately, the Government stepped and provided a limited backstop to the risk potential seen in a terrorist attack. The TRIA program provided the market with enough stability that companies were able, once again, to provide the necessary insurance coverage with the assurance that the Government would help absorb the initial blow in the face of the event but yet require that the Federal taxpayer would be able to recoup most, if not all, of the Federal assistance that was paid out.

I was the author of the original bipartisan TRIA legislation. I watched its evolution closely over time.

The TRIA program is one of the, if not the, best post-9/11 pieces of legislation. It is the Government working with the private sector when neither could solve the problem on its own.

And it has worked, most importantly. We now have a track record. Before this, when we first passed it, people were saying this and that and the other thing.

One example, the redevelopment of the downtown of my city. Right after 9/11, people were saying, below Canal Street would become a ghost town; no one would want to locate there for fear of a repeat incident.

Obviously, everyone across the country feared terrorism, but no people worse than downtown, which suffered so much.

And so I believe it is very important we reauthorize the program and extend it as soon as we can for as long as possible. There is broad support for this program from Members of both sides of the aisle.

I plan to continue working with you, Mr. Chairman, and Ranking Member Crapo, as well as several other Members of the Committee, to introduce bipartisan legislation to reauthorize TRIA in the coming months.

And I would just say one other point. You can be a purist and say this is something the Federal Government should not be involved in, and that is what we believed in the 1890s.

And then, when natural disasters occurred, there was a general consensus in this country that these were so large that they could not be handled by individuals or individual companies alone.

Nine-eleven was the first time there was a man-made tragedy or man-created tragedy of that extent. And the same exact logic applies.

So, yes, you can go back to a pure view; let the market just work it out. We have learned that when we do that in certain instances everyone is hurt.

And so I would urge my colleagues not to be dogmatic on this issue but look at the practical reality of the situation and move forward on the bill.

So the one question I would like to ask you all, first with Mr. Walter and then others who want to comment—if Congress were unable to pass or reauthorize legislation until November or December of this year, can you please talk about the economic impact on our economy and jobs, which we all agree is the number one issue that we face?

Mr. Walter, why don't you start?

Mr. WALTER. Thank you, Senator.

If we were to wait until the end of the year to reauthorize TRIA, I think the primary risk that we would run in the property area and the real estate sector is simply that new development and new financings would be held up as both lenders and borrowers strove to try to deal with what happens if you do not act.

While it is great to have a confidence level that the program would ultimately be passed, it is not done until it is done, and lawyers and lenders and borrowers will all struggle to deal with the potential aftermath of what happens if it is not extended.

Senator SCHUMER. At the very least, it would raise the cost of things, wouldn't it?

Mr. WALTER. So everything gets more expensive. And depending upon the scale of the proposed development or the scale of the proposed financing, whether it is in a rural area or in a city, the reality is that larger projects—this risk will be exaggerated, and those projects will slow down, waiting for you to act.

Senator SCHUMER. OK, Ms. Snow.

Ms. SNOW. I think from an insured's point of view that it puts a lot of uncertainty into the programs, into the insurance programs. And, with sunset clauses on the coverage of TRIA, it creates higher premiums because those premiums—if you want to buy coverage beyond the extension of TRIA, those premiums are nonrefundable; those deductibles are high.

So it creates a lot of uncertainty on behalf of the insurance buyers. It puts a lot of uncertainty on the market.

Senator SCHUMER. My time is expired.

I thank you, Mr. Chairman, and thank my colleagues.

Chairman JOHNSON. Senator Coburn.

Senator COBURN. I am fairly new to the banking industry but not new to following TRIA.

Let me give you a quote out of the original TRIA legislation:

> Provide temporary financial compensation to insured parties, contributing to the stabilization of the United States economy in a time of national crisis, while the financial services industry develops the systems, mechanisms, products and programs necessary to create a viable financial services market for private terrorism risk insurance.

That is what we set up.

In listening today, my question is, is there a doubt that there will ever be, in your minds, a private terrorism risk insurance without a TRIA program? Will market forces actually ever work for this system?

Mr. HENRY. Senator Coburn, I believe at the time everybody was in a state of shock, and maybe that is what we thought.

But I can tell you, having dealt with this ever since 9/11, in my mind, there will never be a permanent solution because it is a permanent problem that really is not subject to insurance in the technical definition of insurance. You do not have predictable losses. You do not have empirical data on which to base a premium.

In our industry right now, it is highly competitive and not just in the United States but in the world, and people are always looking for new products. If there was a substantial amount of availability, there would be a market for it. But what market there is, I can tell you, is at a premium.

I sit on the board of a mutual insurance company, a successful mutual called Signal Mutual. They insure stevedores, shipbuilders, ship repairs for the Navy, all the maritime employments.

After 9/11, we were bare. We had to assume the risk.

After TRIA was passed, we were able to buy up to our deductibles with a certain deductible ourselves.

These are all the national defense firms. These are the people that load and unload ships coming into our ports and harbors. And, if TRIA goes away or if we cannot get sufficient capacity, the price for this coverage will go up or it will go away completely.

The way a mutual works is all the members, which for Signal are the major maritime employers in the country, will get a price rise. And they will not keep that internally. That price increase will go to the consumers.

If the market was there, I think we would have found it, but I do not believe we are going to see it in our lifetime.

Senator COBURN. Mr. Donnelly.

Mr. DONNELLY. Senator, my response to your question is I hope so, but I echo Mr. Henry's comment that one of the things that has not changed in 11–12 years—and I do not see in the foreseeable future—is the insurability, the definition of insurability, the ability to really predict with any reasonable certainty of what outcomes are going to be.

And I also would submit, though, that there is a lot of private capital that is at risk in the market today, and the capital—keep in mind that the capital that an insurance company has is there to pay for all the risk that it has—the average automobile accidents, the fires, the slips and falls, the worker's comp injuries and all of those.

So there is a finite amount of capital that the industry for any event, no less something like terrorism—which again, by definition, is not one that one is able to predict with any degree of certainty, the frequency or the severity of loss.

And the fact is the events are not random. They are, in fact, intentional.

And I would add the comment that my own view is that one of the other reasons that the Federal Government, I think, needs to play a role in this whole risk management plan is at the end of the day the Federal Government is the risk manager here.

We work with—our insurers are mainly a worker's comp company, and we work with our insureds to try to help prevent accidents from happening and do all the things you can possibly do.

At the end of the day, I think the Government here has a responsibility as the risk manager and, therefore, certainly long-term, needs to be part of this plan.

Senator COBURN. Well, let me challenge you a little bit on that. The Federal Government is the people of this country, and they are going to pay the risk.

So the question is whether we pay it through the Government or pay it through increased premiums. One way or another, the loss is going to get covered, correct?

One way or the other, it is going to get covered. It is going to have an impact on the economy.

So the question it comes back to is, why can we not develop private terrorism risk insurance?

There are a lot of things that are insured. You can go to Las Vegas and insure anything. All right?

The question is, is the premium affordable as you measure that?

And my question is, what has the industry done to develop forward, to try to get us to a point where we can do that?

Mr. Elliot?

Mr. ELLIOT. Senator, just a few thoughts.

There is no question; in 12 years as an industry, I think all our companies do a much better job today modeling events, and we also do a much better job at looking at aggregate exposures.

What we are just as challenged with today is understanding in pricing and underwriting terrorism, and I think we have not been able to move that ball along.

And all of us talk about the possibilities that may happen in this country, particularly around NBCR and the magnitude of those losses. I do not see the private market providing that type of capacity, not only in the near term but in the long term.

Mr. HECK. May I add something to that?

It is true that we had hoped that a market would develop.

The problem—the big problem with underwriting terrorism—there are a number of problems. But it is a deliberate act. So it is all or nothing.

The capacity which has developed is allocated based upon the exposure, and what is considered a very high-risk area has very little capacity.

So it really does not seem possible that a market could ever develop to fully satisfy the need for terrorism.

It seems to me that the TRIA method, the TRIA mechanism, is the best one because it does spread the risk. If there is a serious event, it can all be paid back to the Government. It is spread over time. It seems very workable. It seems like a very good idea, and it has worked very well.

Chairman JOHNSON. Senator Menendez.

Senator MENENDEZ. Thank you, Mr. Chairman, and to you and the Ranking Member for having this hearing that I think it is incredibly important.

You know, I look at the question of that it is unusual to have any Federal backstop unless we have a public interest or a breakdown in the private market where a Government role is needed to restore functionality. And, in the case of terrorism risk insurance, I think in my view, we have both.

If terrorists attack the country, the United States has a national interest in minimizing the economic harm they inflict.

And, in terms of market functionality, unless private actors, which seem to me inherently limited in the things they can do to evaluate and reduce their risk—for example, should insurance companies start their own intelligence agencies to improve their predictive models or commercial real estate owners conduct counterterrorism operations to lower their premiums?

Now that may be a bit extreme, but the point is that there are certain elements to make determination of risk in the marketplace that are particularly difficult when it comes to the potential act of terrorism.

So one just for the record, whoever wishes to answer it—what makes terrorism different from other risks that, therefore, should elicit a Federal backstop?

Mr. Elliot?

Mr. ELLIOT. Senator, let me start. I would say at the core of that question is the fact that terrorism is an intentional act, and that is different than anything else we underwrite or insure or price as an industry and as a company, and that makes this incredibly challenging.

Mr. DONNELLY. I can say a couple of other things.

One is, fortunately, we do not have a long history to know how many events. So, when you think about models, you try to look at the frequency of events as well as the severity. And I think the wide range of possibilities of what destruction can be makes models just blow up in terms of the possibilities for that.

The other thing—and it is sort of back to what Mr. Elliot said about intentional. One of the things when I think about hurricanes or things like that is there is risk mitigation techniques you can do in terms of building codes and all sort of things like that, that try to minimize the damage.

The terrorists, they think, are constantly trying to figure out how to get around the risk mitigation techniques that are used by the Government or by business and so forth.

So there is a uniqueness to that, that we have a man-made event where somebody is trying to constantly reinvent how to create a particular attack which is different than what we have seen in natural catastrophes and so forth.

Senator MENENDEZ. Mr. Henry?

Mr. HENRY. In my mind, it is similar to a war risk. The industry has no control over that and cannot know the severity.

Keep in mind I think some people think that the industry has unlimited capital, but the fact is the insurance industry in the United States probably has $600 billion in capital. It would be easy to see $100 billion loss and maybe even a trillion dollar loss if it were a direct hit on New York City.

Keep in mind the World Center Trade Center was a very specific target, and in today's dollars, we are looking at $42 billion on that.

Thank you, sir.

Senator MENENDEZ. In another context of this, what would be the consequences of letting TRIA expire for communities in this country that build or operate critical infrastructure such as rail lines, power plants, highways, airports, pipelines?

If these investments become more costly, doesn't that have a nationally adverse impact?

If you look at the region that Senator Schumer and I are privileged to share, we have a two-mile stretch that contains the largest container port, the mega-port of the East Coast, one of the busiest set of airports in the country, rail lines that carry hundreds of thousands of people back and forth to work every day, critical industrial infrastructure, not to mention high population densities.

But that is not unique to us. There are other regions in the country that emulate that in their own way.

What would be the consequences of having no Federal backstop in terms of insurance to regions like that in our country, that are drivers and a great part of our economy?

Mr. Walter?

Mr. WALTER. Senator, I think the most natural result from that, especially if it is in the public sector, is probably what happens is that there will be no insurance to deal with those problems when they occur, and so either the State or the Federal Government will end up being the insurer because the private sector does not have the capacity to step in without a TRIA backstop.

And, consequently, that means that it will not be there for those different sorts of infrastructure situations. And so, when the problem occurs, the Federal Government or the State government will really become the insurer.

Senator MENENDEZ. And, in the absence—final question. In the absence of insurance, then doesn't any future infrastructure development of that size and magnitude become far more costly and, as such, become a question as to whether or not it gets built, which then becomes a question of economic opportunity for the future?

Is that a fair statement? Does anybody disagree with it?

Mr. HENRY. And who is going to write the insurance on the workers that are doing that rebuilding?

Senator MENENDEZ. Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Heller.

Senator HELLER. Thank you, Mr. Chairman and to the Ranking Member, for holding a second hearing here on TRIA. I certainly do appreciate that.

I also want to thank you for responding to a letter that Senator Kirk and I sent to you back in December about moving this process and this issue forward. Thank you very much for that.

I want to thank all our guests and those that are here with us today, having the expert panel with us, to discuss these issues.

And I want to also make the point that I am willing to work with anybody and everybody on this Committee so that we can move this process forward.

I want to talk about something. I know I walked in a little bit late, and maybe these questions were already asked, but that is what happens actually when you are at the bottom of the totem pole, here at the end.

So I want to talk about cyber terrorism for just a minute.

I want to start with a quote from former Homeland Security Secretary Napolitano when she stated that at some point, the United States will "face a major cyber event that will have a serious effect on our lives, our economy and the everyday functioning of our society."

So, with that issue and give this dire prediction, what are some of the outstanding questions, and—Ms. Snow, I would like to ask you—what are some of the outstanding issues that remain regarding whether TRIA that can be used if a cyber attack does occur?

Ms. SNOW. Well, as one of the Members of the panel mentioned earlier, it depends on if there is coverage and the underlying coverage. For those accounts that have cyber insurance, then the terrorism would track along with that.

Senator HELLER. Is it being covered or not being covered—cyber attacks—at this point?

Ms. SNOW. If it is under—if you have cyber insurance, it would be covered.

Senator HELLER. It is a specific insurance policy.

Ms. SNOW. Yes.

Senator HELLER. In that coverage?

Ms. SNOW. Yes.

Senator HELLER. Mr. Elliot?

Mr. ELLIOT. It is a specific grant of coverage, and we offer it to some of our clients and customers, and not all.

Senator HELLER. OK, OK. I want to move to Mr. Walter here for just a minute.

You and I have similar interests in that in the State of Nevada we have 35 major hotels, some with as many as 15,000 occupants at any given time. Thirty-nine million guests from every State come to Las Vegas every year. I think we have an additional 700,000 annually that come from foreign—as foreign visitors.

So I think a terrorist attack on this country, especially in Las Vegas, would have serious consequences, not just Las Vegas but any resort hotel—Orlando, Los Angeles, New York. You name it.

So how important is it, though, to the hotel and travel industry for TRIA to be renewed?

Mr. WALTER. It continues to be incredibly important to our industry for TRIA to be renewed.

We are already taking every precaution we can in our hotels, in casinos and in our industry to try to protect the buildings that we have but, more importantly, the employees that work at those buildings and also the guests that are there. We are taking all the steps that we can to try to prevent a terrorist attack short of forming our own CIA to try to gather intelligence or our own military group to try to conduct counter-terrorist operations, which obviously make no sense for the industry to do.

Ultimately, TRIA provides a solution for us as an industry in the event the unthinkable happens again. And, if something happens in Las Vegas or in any other locales that you identified, the reality is that assuming we have purchased terrorism insurance, which I am sure most of us are doing, the reality is we have a solution for how to deal with all the issues that arise from that problem and rebuild and allow the Nation and that city to continue to move forward.

Senator HELLER. If TRIA were to be renewed later rather than sooner, what impact would that have on the growth of the industry?

Mr. WALTER. Well, I think the reality is all major projects would slow considerably until it was clear what was going to happen with TRIA because especially in the construction area, the construction lenders, after they get comfortable with the project, their first worry is how they are going to be repaid. That means who is the permanent lender that is going to step in and repay them.

And, if they are not clear on how that permanent lender is going to deal with TRIA, or with terrorism insurance—and right now, all the lending community, as we meet with our various lenders, they have all indicated that they are all expecting us to maintain terrorism insurance irrespective of whether TRIA is renewed.

So, if the lenders want it, the program does not exist and the construction lender cannot see how it is going to be provided, I think most construction lenders are going to stop lending. And so that slows construction and development.

Senator HELLER. Ms. Snow.

Ms. SNOW. I would like to add it is not just the big businesses that will be impacted but the small businesses that depend on those other businesses. So I think the impact on the economy would have a very wide-ranging effect because of all the small businesses that would also be impacted.

Chairman JOHNSON. Senator Warner.

Senator WARNER. Thank you, Mr. Chairman. Thank you and the Ranking Member for holding this hearing.

And, echoing what Senator Heller said, when you are down at the end of the dais, sometimes a lot of your questions have already been re-asked.

So I am going to join with all of my colleagues, or most of my colleagues at least, in urging that we move sooner on this legislation rather than later. I think it has been clear that across the panel there was no indication that anybody from the private sector has suggested that there is a credible private sector-only solution here.

I think it is unusual that some of our friends in the House are talking about solutions that would have no Government backstop at all. But it seems to me that because it is so hard to price for a black swan-type event, which is what the terrorism event would entail, that even if there was, theoretically, the ability to create a private insurance-only market the pricing would be so high that it would be a malallocation of resources, not only in terms of the insurance industry but in terms of the ability for infrastructure and economic redevelopment to take place.

Is there any disagreement with that basic premise?

[Shaking head negatively.]

Senator WARNER. And then, secondarily, I think that—and as Senator Corker pointed out—in the moments of crisis, the American people are going to expect us from the Congress to react, and chances are, at the end of the day, the public is going to be on the hook anyway.

So why not take a program that has developed?

And I might ask, Mr. Heck, for you to reaffirm the fact that it should not be tweaked at all.

Whether we tweak or not a bit but make sure that we get this done sooner than later, I guess, is point one.

Point two would be echoing what Senator Heller and, I think, what Senator Crapo raised on cyber. I think this is, again, a huge new area.

I believe, unlike where there are already established norms around building codes and other areas that say we set a standard already and, consequently, the risk is kind of borne across the whole industry of buildings, in cyber, it does argue again for the fact of how we get this right without undue Government interference, finding that sweet spot, but that in the cyber space you may have cyber attacks that would not be economy-wide but might be industry-focused.

And there will be a responsibility to make sure that those within industry who are free riders—if you have got a dozen entities in a particular industry who are doing the right thing on cyber protection, but as we may see with certain data breaches already going on right now, that there could be weak links.

Again, this argues to the point of how we set some standards that are robust enough and whether it is insurance-set or governmental public-private-set is an area that I think we are going to have to come back and revisit.

Last point is—and I will get a question in before my time expires—Senator Schumer asked a little bit about what happens if we wait too long. Senator Corker made the point that we should not wait until lame duck to do this. Again, I would support both of those colleagues' comments; the sooner the better, right after GSE, not before GSE.

But are we already seeing—with the expiration of TRIA at the end of this year, are we already seeing in new starts or in leasing, uncertainty, because of that due date coming along and, candidly, Congress's not very good record, not this Committee, but Congress's not very good record of hitting timelines?

Anybody on the panel?

Ms. SNOW. I will answer that on behalf of the insureds. Yes, some of our insurers are already seeing what are called sunset clauses, where the coverage may actually expire with TRIA, or they are offered standalone policies where they can buy the coverage beyond, but the premiums are very high and the deductibles are very high.

So, yes, there is already an impact in the market and an impact on worker's compensation pricing.

Mr. DONNELLY. I would echo those comments, Senator, in that I think many insurers are putting endorsements on policies to protect themselves if, in fact, significant condition changes, *i.e.,* that TRIA expires and is not reauthorized.

Mr. HENRY. And, Senator, what you are already seeing in addition to these, but we are not really seeing up front, is the carriers are re-underwriting concentrations of exposures. They are not telling us about that, but I promise you they are doing it.

Senator WARNER. Is that also translating down to slower economic activity, I guess, not only in——

Mr. HENRY. No question. And, if I am a lender and I have got a billion dollar project in Vegas that I am getting ready to fund and I get a builder's risk that has a sunset clause or says no TRIA-no coverage, I am not sure I am going to make that loan.

Chairman JOHNSON. Senator Warren.

Senator WARREN. Thank you, Mr. Chairman.

I think it is clear from all that we have talked about and all we know that TRIA has served an important function in this market. It has given us certainty when we would not have had it. It has given us commercial development. It has not cost the taxpayers a dime.

I hope that we are going to move forward on TRIA soon, but I do have a question about it and a question about whether there should be a change in how it is done.

And that is in other forms of insurance you pay a fee up front. Under TRIA, the Government does not get any fee up front for providing this insurance. Instead, if there is a loss, the premise is that the Government will recoup on the back end after the terrorism event has occurred.

And everyone in this hearing has been talking about the enormous pressure there will be on the Government to absorb the losses by the taxpayers generally.

So I am a little concerned that that same pressure is going to be there because of TRIA. Nothing is going to change because of that.

So the question I have is, what kind of market impact would it have if we collected a modest fee on the front end for TRIA?

And I thought maybe I would start with you on that, Mr. Elliot.

Mr. ELLIOT. Absolutely. Thank you, Senator.

Let me share just experiences in the marketplace over the last couple of years to give you a sense of my answer.

Number one, I would say that we would have to establish prices for that exposure.

Senator WARREN. Yes.

Mr. ELLIOT. And experience has suggested to us that as you raise prices, particularly that middle market customer, they are electing not to purchase. We see take-up rates in the small customer segment much higher than we do in the middle market. And so I would be concerned that the take-up rates go down in the middle, and in effect, we are going to have a looming issue that will come back to this Government in a different form on a different day if we are not careful about how we institute that.

Senator WARREN. So let me just make sure I am understanding what you are saying, Mr. Elliot. What you are saying is, in effect, prices would go up if we actually paid anything at all for that insurance, which tells me right now you are not pricing for the risk that the American taxpayer is absorbing.

So you are not setting any money aside for this right now. That is, if an event of terrorism occurs, you are expecting the U.S. Government to absorb all these losses and then turn to you, and you have not set a dollar aside for being able to absorb any of those losses down the line?

Mr. ELLIOT. We are pricing for our retention, just as you describe, and——

Senator WARREN. But you are not pricing for the fact that under TRIA the U.S. Government is supposed to come back and collect for you.

Mr. ELLIOT. That is correct. That is correct.

Senator WARREN. So, in other words, this is just a giveaway program from the U.S. Government that you are not pricing for now?

Mr. ELLIOT. I think the backstop, the program itself, has been a fundamental opportunity to allow us to engage and offer coverage.

Again, our net retentions in this business are $34 billion across the industry, and I think it has been a very successful public-private relationship.

Senator WARREN. But no retention to cover the part that the American taxpayer, as a matter of law, is supposed to come back to you and you are supposed to pay for, not the American taxpayer.

Mr. ELLIOT. Right, that would be a forward recoupment in the sense of this program at the moment.

Mr. DONNELLY. And, Senator, I would echo Mr. Elliot's comments in that the post-funding, if you will, is, I think, a much more efficient way for us to fund this.

If we were to collect something today, we would be making an estimate of what that is.

I mean, we are talking about something that is way out in the tail, back to—and the fact is there is a very defined mechanism, whether it has to be tweaked or not, which was asked earlier. In terms of where the recoupment, there is a very defined mechanism in place.

Certainly, is there a liquidity issue in terms of how the money would move? I would say yes to that, but there is a mechanism in place to make sure that the taxpayer is paid back.

Senator WARREN. Well—but let me just make sure I am understanding that. I understand that it would be difficult to price this. But, is there anyone who believes that the price is zero?

[No response.]

Senator WARREN. I am hearing you say no.

No one believes that the price is zero, and yet, that is exactly what you are paying for it right now. You are paying zero.

Mr. DONNELLY. I guess, Senator—I guess I would say again I believe it is a much more efficient way in that if, God forbid, there is an event that happens and it becomes a dollar amount that has to be recouped, there is a defined mechanism in place to go about collecting that over some period of time, up to $27.5 billion.

Senator WARREN. I appreciate—I am afraid I am going to be out of time here, but I really do have to say on this; this whole thing is premised on the fact that the U.S. Government will be called on to backstop if there is an event of terrorism. That is the reason we put TRIA in place.

But we put TRIA in place to say we are going to get some sharing on those costs, and yet, it seems to me the same pressure is going to be in place on the U.S. Government to absorb these losses if there is no mechanism in place to have at least offset some of those costs ahead of time or if you are not setting any money aside to absorb those losses on down the line.

So I do not see how the pressure changes this, and it just raises for me some serious questions about TRIA.

Chairman JOHNSON. Thank you again to all of our witnesses for being here with us today.

I will continue working with Ranking Member Crapo and my colleagues on the Committee to move a bill to extend TRIA as soon as possible.

This hearing is adjourned.

[Whereupon, at 11:23 a.m., the hearing was adjourned.]

[Prepared statements, responses to written questions, and additional material supplied for the record follow]:

PREPARED STATEMENT OF SENATOR MARK KIRK

I want to thank the Chairman and Ranking Member for having this hearing today. There are a number of us on this Committee who represent States that have experienced terrorism attempts and/or have cities that are key terrorism targets. Since 9/11, there have been no fewer than seven failed terrorist attempts and one actual attack—occurring in Chicago as well as rural areas of Illinois. That being said, terrorism is not a west coast or east coast issue. Terrorism attempts have been plotted throughout the country with no fewer than 29 States and the District of Columbia having terrorism plots uncovered since 9/11. Further, the entire country feels the economic impacts and upheaval when a terrorist event occurs. Immediately after the 9/11 attacks the Dow dropped more than 600 points, worsening the 2001 recession and the Federal Reserve added $100 billion in liquidity per day during the three days after attack to help avert a financial crisis.

Terrorism is also not just an insurance industry issue. TRIA helps protect U.S. consumers and taxpayers, including 5.8 million Illinois workers and a multitude of high value commercial properties including Chicago's Willis Tower, O'Hare Airport, the Soldier Stadium, several Illinois bridges, and five major U.S. military installations just to name a few.

Terrorism risk is extremely unique in that it is a national security issue that can cost tens of billions of dollars, if not much more; is extremely difficult, if not impossible to model; and has long-term economic and security impacts for our country. In the wake of 9/11, I think our Government responded exceedingly well by creating a public-private partnership to ensure the private market can respond and can functionally absorb a vast majority of losses due to a terrorist event. These efforts shield the taxpayer from substantial costs while also providing for a system that enables private market to retain a significant portion of terrorism risk.

Prior to 9/11, coverage for losses from terrorism was typically included in general insurance policies—however, throughout 2002, coverage for losses from terrorist attacks was not available. Fearing a larger economic impact from the lack of insurance, Congress passed the Terrorism Risk Insurance Act (TRIA) requiring insurers to offer terrorism coverage and created a 3-year program with shared loss risk between the Government and private insurers in the event of a terrorist attack. TRIA was extended via the Terrorism Risk Insurance Extension Act (TRIEA) of 2005 and again by the Terrorism Risk Insurance Program Reauthorization Act (TRIPRA) of 2007, and is set to expire on December 31, 2014. Each reauthorization made improvements and reforms to continue to make the program its best and to ultimately protect the taxpayer.

However it is important that we act now to make our reforms and reauthorize TRIA to ensure stability in this important market place. Uncertainty surrounding the reauthorization of TRIA is already affecting insurers' ability to offer future policies. Industry experts agree that removing this federal backstop would result in a vacuum for terrorism risk insurance, even though the 60 percent take-up rate shows robust demand. Modeling and predicting terrorism events is simply too difficult, especially given insurers' limited access to necessarily classified national security information. As we saw in the wake of 9/11, without terrorism risk insurance, investors and developers are unwilling to finance construction projects, stalling economic development nationwide.

TRIA protects taxpayers by requiring the insurance industry to share and recoup losses covered by the Federal Government in all but the largest terrorist attacks. Should this program lapse and coverage be unavailable, the Government, and therefore the taxpayers, would face pressure to cover uninsured losses completely.

The TRIA insurance program is very different from many other Government insurance programs—namely because it is a public-private partnership that does not require the Federal Government to assess or underwrite risks. Another difference is that this risk is difficult, if not impossible, to effectively model and brings into question the Government's role in national security and possible "acts of war". Because of these unique complexities and national security issues, the only effective and most fiscally responsible way to address this risk was through a public-private partnership. Additionally, unlike other Government-backed insurance programs, the private industry is on the hook for first losses, exposure to the Federal Government is limited, and any costs incurred by the Federal Government are to be recouped by industry within a specific timeframe ultimately leaving no cost to the taxpayer.

Fortunately, our country has not had to utilize the TRIA program after enacting this legislation in the wake of 9/11, since by design it was created to only kick-in only for large-scale events. While this will mark the third time that TRIA legislation has been reauthorized and while I believe that the current program is functioning in the market place the way it was intended, I also believe it is prudent to identify areas for continued improvement. I look forward to exploring ways that the taxpayer can be further shielded from significant losses from a terrorist event while at the same time ensuring that the private market does not retreat from this critical market space.

PREPARED STATEMENT OF SENATOR TOM COBURN

When the Terrorism Risk Insurance Act (TRIA) was originally authorized in 2002, Congress found that the Federal Government should "provide temporary financial compensation to insured parties. while the financial services industry develops the systems, mechanisms, products, and programs necessary to create a viable financial services market for private terrorism risk insurance." Twelve years later, the Committee is discussing the extension of the federal backstop for a fourth time without any consideration for the program's original intent to temporarily bridge the gap between post-9/11 economic distress and a permanent private sector solution. While I appreciate that the Chairmen and Ranking Member will consider taxpayer protection reforms as part of a reauthorization, I am concerned that the Committee is escaping the fundamental question of whether or not TRIA is a permanent federal program. If so, does the framework of the temporary transition program remain appropriate for a permanent taxpayer provided backstop? If not, how can Congress create a wind down of TRIA that will facilitate private sector solutions?

Unfortunately, the existence of TRIA and Congress' willingness to extend the program without indicating a clear endpoint eliminates the incentive for industry to develop private market mechanisms for terrorism risk coverage. The current setup where all of the gains are privatized while some of the losses are socialized is not an environment that fosters innovative solutions and accurate pricing. For example, despite their ability and willingness to expand terrorism risk capacity, private reinsurers cannot possibly compete with the free reinsurance provided by the American taxpayers. The unwillingness to even discuss a wind down of TRIA and potential perpetuates the disincentives to innovate beyond the current TRIA framework.

Based on the witnesses' prepared testimonies, it appears the industry does not believe there is a plausible private sector solution available and that the absence of a private solution justifies a permanent federal backstop for terrorism risk coverage. If there is no way to maintain a stable terrorism risk insurance market without a federal backstop, then insurance companies should pay for the taxpayer provided service with upfront premiums. The tenets of a temporary solution from 12 years ago are no longer appropriate for this long-term permanent program.

Instead of reforming around the edges, it is time for Congress to decide whether or not TRIA is a permanent program. If so, it is time to scrap the generous framework that was created when TRIA was thought to be a temporary patch in 2002 and ensure that taxpayers are compensated for the coverage they provide with upfront premiums. If not, Congress should declare a clear transition away from the public backstop to allow private capital, competitive pricing and innovative solutions to fill the space.

PREPARED STATEMENT OF W. EDWARD WALTER

President, Chief Executive Officer and Director

Host Hotels & Resorts, Inc.

on behalf of the Coalition to Insure Against Terrorism

February 25, 2014

Good morning Chairman Johnson, Ranking Member Crapo and Members of the Committee. My name is Ed Walter, and I am the President and CEO of Host Hotels & Resorts. Host owns or has interests in more than 140 hotel properties in 15 countries, 24 States and the District of Columbia and is one of the largest owners of hotels in the world. I am a member of the Executive Board, and just recently concluded my tenure as the Chair of the National Association of Real Estate Investment Trusts, the worldwide voice for REITs and publicly traded real estate companies with an interest in the U.S. real estate and capital markets. I also serve on the Board of Directors of The Real Estate Roundtable.

Today though, I am testifying on behalf of the Coalition to Insure Against Terrorism, or CIAT. CIAT is a broad coalition of commercial insurance consumers, formed after the September 11, 2001 attacks to ensure that American businesses could obtain comprehensive terrorism insurance. The diverse CIAT membership covers virtually every sector of the private economy as well as public sector buyers of insurance. For example, the U.S. Chamber of Commerce, the National Association of Manufacturers, and the National Retail Federation are members. So are, to name a few sectors, transportation interests (*e.g.,* the Association of American Railroads, the General Aviation Manufacturers Association, and the Taxicab, Limousine and Paratransit Association), utilities (*e.g.,* American Gas Association, American Public Power Association, Edison Electric Institute, and National Rural Electric Cooperative Association), finance (*e.g.,* American Bankers Association, America's Community Bankers, Mortgage Bankers Association of America), real estate (American Resort Development Association, National Association of REALTORS®, Building Owners and Manufacturers International, International Council of Shopping Centers, and National Association of Industrial and Office Properties) and sports (*e.g.,* the Baseball Commissioner, NCAA, NBA, NFL, and NHL). Simply put, CIAT is the true consumer voice on terrorism risk insurance, as we are comprised of the principal policyholders of commercial property and casualty lines of insurance in the United States.

I am here to strongly urge that Congress renew the Terrorism Risk Insurance Act, or TRIA, as soon as possible, and certainly prior to its currently scheduled expiration at year end. Without adequate terrorism insurance coverage, our economy, our jobs and our well-being become more vulnerable to terrorism. Maintaining a workable Federal terrorism insurance mechanism is vital for our Nation's economic security. The clear record of this Committee's previous hearing last September amply demonstrated that.

My own company was deeply and personally affected by the terrorist acts of September 11. Host lost our Marriott World Trade Center Hotel, which was destroyed by the collapses of the two World Trade Center towers, and our Marriott New York Financial Center Hotel located two blocks away was also heavily damaged. Much more importantly, we suffered the loss of two hotel employees.

Economic Impact of 9/11 and the Enactment of TRIA

As you know, the September 11th terrorist attacks cost insurers about $36 billion. For those of us who had commercial insurance policies, the financial losses suffered as a result of the attack were covered by the insurance policies in force at the time. All of this changed after September 11. The potential for extraordinary terrorism-related damages and a heightened awareness of the magnitude of future risk caused a downward spiral in the insurance market. First, reinsurers left the market, and then many primary insurance carriers effectively stopped providing coverage of terrorism-related losses. After the September 11th attacks, Host's property insurance costs nearly tripled, while the amount of coverage declined by 70 percent.

The uncertainty surrounding the future of terrorism insurance contributed significantly to a paralysis in the economy, particularly in construction, tourism, business travel and real estate finance. According to a study by the Real Estate Roundtable, in the 14 months between the 2001 attacks and the enactment of TRIA, over $15 billion in real estate-related transactions in 17 States were stalled or canceled because of a lack of terrorism risk insurance. Perhaps more troubling, the White House Council of Economic Advisors found there was an immediate and direct loss of 300,000 jobs in that same period from deferred construction. With the entire private sector exposed, the Federal Government took action by enacting TRIA, in November 2002. TRIA provided a limited Government risk-sharing mechanism, while requiring private commercial insurers to offer terrorism coverage for certain acts, and requiring insurers and policyholders to participate in the costs of any eventual claims through both upfront retentions and a post-event recoupment mechanism.

Risk-sharing partnerships are the standard among developed nations for the management of terrorism risk. At least 14 other nations, including most of the major OECD economies, have permanent terrorism insurance laws in place because they too recognize that private insurers and reinsurers alone cannot be responsible for underwriting terrorism insurance.[1] A critical consideration for any future investment will be whether terrorism insurance is available in that country.

The Continuing Economic Need for TRIA

In addition to having stabilized our economy following 9/11, TRIA continues to support our economy by providing a plan to survive a future terrorist event without losing stability or continuity. It requires the insurance industry to bear a significant amount of any claims and also provides a mechanism for the Government to recoup from policy holders the cost of governmental outlays. The continuing need for TRIA

[1] *See* U.S. Gov. Accountability Office, *Catastrophe Risk: U.S. and European Approaches to Insure Natural Catastrophe and Terrorism Risks,* 39 (2005); Airmic Technical, Terrorism Insurance Review, 5 (2013), *available at http://www.willis.com/Documents/Publications/Services/Political_Risk/Terrorism_2013_FINAL_web.pdf.*

is apparent: when TRIA was previously set to expire, private insurers routinely wrote exclusions into policies that would void terrorism coverage in the event TRIA was not renewed. A 2005 poll by Marsh & McLennan of 50 commercial property insurers found that 68 percent of insurers would have excluded terrorism coverage after December 31, 2005 if TRIA was not extended. Similarly, a 2013 study by Aon found that if TRIA is terminated, there would be an 85 percent reduction in insurance capacity for property risks.[2] Because the standalone market would not be able to fill the void, the economic impact of TRIA's expiration would be significant. The issuance of similar "sunset" clauses that would exclude terrorism risk coverage after year end are again likely to result from a failure to quickly extend TRIA well beyond 2014.

TRIA protects both the capital and property markets from considerable disruption. Most existing loans require that borrowers maintain terrorism insurance as part of their overall insurance program. In fact, in 2005, as the expiration of the original Act approached, Host began receiving letters from lenders notifying us that they would require us to obtain terrorism insurance even if TRIA was not renewed. If, as anticipated, the standalone market proves inadequate to satisfy demand created by the nonrenewal of TRIA, companies would face widespread technical loan defaults throughout various industries.

In the current climate, banks and other capital providers have indicated they will not provide new financing without terrorism insurance. As a result, even today, borrowers are being forced to confront the question of what options will exist after year-end 2014. The lack of clarity around this issue will likely slow the pace of new financing, especially in the case of properties that are perceived to be at a higher risk of terrorist attacks such as high profile buildings and real estate generally located in key gateway urban markets.

This problem would be even more troublesome in the case of new construction projects, which are already properly viewed as presenting additional risk to a lender. Construction lenders could back away from lending for these projects because of a concern that takeout financing would be difficult to arrange if terrorism risks cannot be offset by insurance. It is important to add that these uncertainties create delays, which only serve to slow the momentum of our already tepid recovery.

Risk Mitigation: A Priority for Policyholders

It is important to note that policyholders retain the incentive to mitigate risk under TRIA. Building owners and businesses across the Nation have spent hundreds of millions of dollars on enhanced security measures and risk management since 9/11. In fact, reducing real estate's vulnerability to terrorism and other threats—through information sharing, risk mitigation, and building security emergency response planning—continues to figure prominently in the prudent management of commercial real estate. Such efforts include a full range of counterterrorism and target hardening techniques to reduce the vulnerability of real estate as part of the Nation's critical infrastructure and key resources.

Mitigating against the risk of terrorism today is a focus for all building owners and, whether a Federal terrorism insurance plan does or does not exist, it will continue to be an important aspect of managing any facility where people gather to work, shop, play or simply enjoy recreational opportunities.

The Future of TRIA

Some critics argue there is no longer a need for TRIA, stating that the private insurers and reinsurers should have found ways to manage the risk of terrorism and offer the commercial sector coverage for it. But we have seen no credible evidence that the private market alone can satisfy the economy's demand for terrorism insurance, now or in the immediate future. Indeed, from our perspective as policyholders, no one has provided us any evidence or made an effective case that there will be any real market for terrorism insurance at all should TRIA be allowed to expire at year end.

There is, however, plenty of evidence to the contrary. The April 2013 report issued by Marsh states this outright when it says, "In the absence of the TRIA backstop, the needs of policyholders are not expected to be met with regards to terrorism insurance." Similarly, the September 2013 report by Aon states "If TRIA were to expire in 2014 the vast majority of the existing insurance market for terrorism risk would disappear." Additionally, last September, this Committee heard from an array of major insurance brokers, academics and policy analysts expressing belief that pri-

[2] *Response to U.S. Treasury and President's Working Group: Terrorism (Re)Insurance,* Aon, September 2013, at 9, *available at http://www.aon.com/attachments/risk-services/2013-Aon-Response-to-Presidents-Working-Group.pdf.*

vate risk markets cannot provide sufficient capacity without TRIA or something very much like it.

Other critics have expressed concern that TRIA only benefits major metropolitan cities, like New York, Chicago and San Francisco. But terrorism is not just a big city problem. The 1995 Oklahoma City bombing made this clear. According to an April 2010 Heritage Foundation report, at least 30 terrorist attacks have been thwarted in the United States since September 11. Among these, terrorists have targeted a shopping mall in Columbus, Ohio, gas pipelines in Wyoming, a Federal building in Springfield, Illinois and a Christmas tree lighting ceremony in Portland, Oregon. Anywhere that people gather—sporting events, schools and universities, hospitals, shopping centers, a utility or a place of worship—is a potential target for terrorism.

We believe one of the strengths of TRIA is the manner in which it utilizes the private insurance marketplace to manage terrorism risk—indeed, all exposure under TRIA starts with private insurance contracts and, due to both significant retentions and the recoupment mechanism, the ultimate risk-bearers under TRIA are the policyholders and the private insurers. We are always willing, however, to consider ways to further limit taxpayer exposure under the program, which we know is your focus as well.

Overall, we support the current structure of TRIA and are wary of major structural changes since the impact of such changes on the continued availability of terrorism insurance in the marketplace is speculative. We are open to modifications so long as they do not have the effect of restricting the availability of terrorism insurance. We understand that reinsurance capacity for even the existing retention levels under TRIA is limited.[3] This fact alone demonstrates that TRIA is not "crowding out" the private sector.

It is important to point out that the policyholder community bears significant burdens or exposure under TRIA's design, in addition to their normal policy deductibles or self-insurance retentions. First, TRIA caps the total liability of the private insurance industry *and* the Federal Government at $100 billion, so that if a major attack or series of attacks produced total insured losses above that figure, commercial policyholders with claims would suffer a proportionate "haircut" of their compensable coverage even as they were direct sufferers from an attack. Second, under TRIA any Federal share of compensation is to be recouped in subsequent years through retrospective assessments imposed on all commercial policies in covered lines, so policyholders essentially make the taxpayers whole. TRIA is no handout to anyone.

Conclusion

The ongoing risk of terrorism remains acutely apparent to my company: The thwarted 2010 Times Square bombing attempt happened directly in front of our Marriott Marquis, and the Boston Marathon bombings took place just two blocks from our Boston Marriott Copley Place and Sheraton Boston hotels. Because terrorist events follow no pattern, the location and magnitude of losses cannot be reasonably predicted through modeling software as is currently done for hurricane and earthquake risks. Consequently, industry experts have suggested that in the aftermath of another large terrorism event, without TRIA, we would likely face the same situation we confronted after 9/11, with insurance capacity limited, if available at all.

That leads to perhaps the strongest argument for extending TRIA: it's working and at virtually no cost to the taxpayer. After the enactment of TRIA, costs stabilized. And today, commercial insurance consumers have access to comprehensive terrorism insurance, directly as a result of the extension of TRIA. Enacting the Terrorism Risk Insurance Act was the right thing to do in 2002. And Congress did the right thing when it extended and amended TRIA in December 2005 and again in December 2007. TRIA remains the best method to address the cost and uncertainty of terrorism—Congress should once again extend TRIA. Thank you for the opportunity to address the Committee—we applaud your concern regarding this very important issue.

[3] According to Eric Smith of Swiss Re, "Based on the most recent estimate, the total amount of reinsurance capacity available for terrorism in the United States is approximately $6–10b—well below the $27.5b insurance marketplace aggregate retention under TRIA and the $34–35b cumulative insurer loss retentions." *The Terrorism Risk Insurance Act of 2002; Hearing Before the H. Comm. on Financial Services,* 113th Cong. (2013) (statement of J. Eric Smith, President & CEO, Swiss Re Americas, at 4).

PREPARED STATEMENT OF CAROLYN SNOW

DIRECTOR, RISK MANAGEMENT, HUMANA INC.
ON BEHALF OF THE RISK AND INSURANCE MANAGEMENT SOCIETY, INC.

FEBRUARY 25, 2014

Good morning, Chairman Johnson, Ranking Member Crapo, and Members of the Committee. My name is Carolyn Snow. I am the director of risk management for Humana Inc., based in Louisville, Kentucky, and the current president of the Risk and Insurance Management Society (RIMS), on whose behalf I am testifying today. I want to thank the Committee for allowing me the opportunity to speak on this critical policy debate surrounding the reauthorization of the Terrorism Risk Insurance Act (TRIA).

RIMS is a not-for-profit organization dedicated to advancing the theory and practice of risk management for the benefit of our member organizations. We are the largest organization of risk management professionals, representing over 11,000 members worldwide from more than 3,500 entities. Our membership includes public and private entities, both large and small, and spans the economic spectrum from the high-tech sector, real estate, finance, healthcare, energy, transportation, education, and defense.

Effective risk management is the identification of potential risks to an organization and the methods to effectively mitigate those risks. Insurance coverage is a necessary component to risk mitigation, particularly for potentially catastrophic losses, which would include terrorism. Since its inception, TRIA has allowed our member organizations to obtain adequate terrorism coverage at affordable rates. Prior to that, after 9/11 our members were unable to obtain such coverage, which jeopardized many contracts that contained covenants to carry terrorism insurance. For this reason it is vital that the program be extended well beyond its current expiration date of December 31, 2014.

We believe that the availability and affordability of adequate insurance coverage for acts of terrorism is not only an insurance issue, but an economic one. 9/11 proved that the private insurance market alone is unlikely to provide adequate and affordable coverage. In February of 2002, as insurers reassessed their terrorism exposures post-9/11, the Government Accountability Office stated that the "resulting economic drag" from difficulties in obtaining adequate terrorism coverage could "slow economic recovery and growth." In September of 2002, Moody's Investors Services downgraded the rating on $4.5 billion in loans on commercial properties due to lack of terrorism coverage while a survey by the Real Estate Roundtable found that "$15.5 billion of real estate projects in 17 States were stalled or canceled because of a continuing scarcity of terrorism insurance."

The creation of TRIA in 2002 brought stability to this highly volatile situation. By providing a backstop, and assuming some of the market terrorism risk as a reinsurer, the Federal Government has freed up capacity in the private market that would not otherwise exist. This capacity can then be made available to the consumer at affordable prices, which we have seen in the current marketplace.

A 2013 survey conducted of RIMS membership found that sufficient capacity exists in the current market. Ninety-two percent of respondents to the survey answered that they have had no trouble obtaining adequate terrorism coverage over the past 18 months, up from 84 percent in a similar 2010 survey.

This availability of adequate coverage is directly linked to the existence of TRIA. If TRIA is allowed to expire, uncertainty will reenter the marketplace which will have a negative impact on the affordability and availability of terrorism coverage. If the private market is forced to assume 100 percent of terrorism risks, then carriers will look to reduce their exposure, particularly in high-threat areas such as the Northeast and the West Coast. As a result, pricing for this more limited coverage will greatly increase and some carriers may actually exit the market.

The same 2013 RIMS survey, mentioned earlier, found that 69 percent of respondents expect that their terrorism limits would decrease or that coverage would not be offered at all, should TRIA be allowed to expire. Without adequate coverage, many of these organizations may be forced to self-insure; however, in the event of major attack, most would be unable to absorb the losses. Those that could absorb the losses would do so at the expense of other business growth initiatives, which would have a negative impact on our economy.

Expiration of TRIA would also have a negative impact on captive insurance companies. Many of our larger member organizations utilize captives to insure for potential losses from terrorist events. Under TRIA, captives are eligible for TRIA participation, which provides them with the security of a Government backstop. Without TRIA, many captives will be susceptible to failure in the event of a catastrophic loss. This might also result in a domino-effect of failure in other lines of coverage unrelated to terrorist event, but which are also insured through the captive. Few businesses would be able to absorb the resulting uninsured losses.

Another area that will feel the negative impact of TRIA's expiration is in commercial lending. Since the 9/11 attacks, most commercial lenders have required terrorism insurance to be purchased to secure commercial construction and mortgage loans. Immediately following 9/11, it was difficult, if not impossible, for commercial policyholders to obtain the coverage necessary to secure or maintain financing. According to testimony before Congress on September 11, 2012 by the Coalition to Insurance Against Terrorism, over $15 billion in real estate transactions were "stalled or even canceled" due to a lack of terrorism coverage in the 14 months following 9/11. Further, CIAT cited a White House Council of Economic Advisors statistic confirming the loss of 300,000 jobs from deferred construction investment.

In 2005, as TRIA approached expiration, many insurers began placing sunset provisions into their policies to address a lack of coverage should TRIA have been allowed to expire. Our members are already reporting a similar circumstance for policies that extend beyond December 31 of this year. Some policyholders are being offered stand-alone policies for the period extending beyond 2014, but with deductibles or premiums that are nonrefundable should TRIA be reauthorized at a later date. This situation creates a great deal of uncertainty in the financial and construction markets that we expect will only get worse the closer we get to TRIA's December 31 expiration.

The impact on workers compensation coverage is already being felt as some companies with workforces concentrated in major urban areas are seeing workers comp price increases of 5 percent to 10 percent as insurers look to limit their terrorism exposure, should TRIA be allowed to expire. In the 2013 survey of our membership, 20 percent of respondents anticipated having trouble obtaining coverage if TRIA is not reauthorized. A January 5, 2014 article in *Business Insurance* stated that experts have projected that middle-market firms can expect workers comp premium increases of 5 percent–10 percent, while national employers with large deductibles or retentions can expect 2 percent–4 percent increases. This increased pricing could force organizations to take on high-deductible programs or to self-insure, which again, places the organization's business future at stake.

As the Committee continues to review and study the issue of TRIA reauthorization, we would like to make our recommendations for areas of improvement. The devastating Boston Marathon bombing raised questions about how the certification process is currently handled under TRIA. To date, no formal declaration has been made as to whether the event will or will not be certified as an "act of terror" under the program. Insurers and policyholders remain unsure as to which claims will or will not be paid and/or covered by terrorism insurance. If the event is certified then those policyholders who chose not to obtain coverage may be unable to recoup their losses; however, if the event is not certified, then those who elected to obtain terrorism coverage may find difficulty in having their claims paid.

Under the current program, a terrorist act must be certified by the Secretary of the Treasury in concurrence with the Attorney General and Secretary of State. We recommend streamlining this process by consolidating this decisionmaking authority within one office or department. We also recommend a 60-day deadline, with the possibility for one extension, from the date of the attack, for a determination to be made. This would allow policyholders and carriers to know exactly when to expect a determination and for the claims process to begin. We also believe that the definition for an "act of terror" should be reviewed to ensure that there is a clear definition of what will or will not be considered a terrorist event.

Another area of improvement relates to coverage for nuclear, biological, radiological, and chemical (NBCR) events. The current program neither explicitly includes or excludes NBCR events, which has prompted many insurers to exclude NBCR events from terrorism policies based on long-standing standard exclusions for nuclear and pollution risks. As a result, consumers are generally unable to obtain adequate NBCR coverage. Based on our membership survey, only 23 percent of respondents currently have NBCR coverage and 58 percent of those without coverage are unable to obtain coverage because it is not offered, or is simply unaffordable. However, 83 percent of those respondents believe NBCR coverage should be made available. For that reason, we support an explicit inclusion of NBCR coverage, under the program's make available provision, in a long-term extension of the program. NBCR events have a high probability of resulting in catastrophic losses for organizations affected by such an attack. Without coverage these organizations are at risk of going under should such an attack occur. In such an event, it is likely that the Federal Government will step in to provide assistance to these organizations, but without the TRIA style public/private loss sharing mechanism in place.

By making NBCR fully covered under TRIA, both sides will know their responsibilities to consumers should such an event occur.

In conclusion, we feel very strongly that a public/private partnership provides the best alternative to addressing the long-term needs of availability and affordability of terrorism insurance. Such a program ensures an orderly and efficient response to acts of terror, which minimizes market disruptions and ensures benefits are available to all victims. Further, we believe that having TRIA in place, should an attack occur, will help avoid the wasteful Government spending that so often accompanies an unplanned, haphazard response to such an event.

I, and RIMS, appreciate this opportunity to testify and thank the Committee for continuing this very important discussion in advance of TRIA's expiration. We are committed to serving as a resource as your work continues on the program's potential reauthorization. Should you require additional information or have any questions regarding RIMS policy positions, please do not hesitate to contact Nathan Bacchus, RIMS Sr. Government Affairs Manager, at *nbacchus@rims.org.*

PREPARED STATEMENT OF BILL HENRY

CEO, McQueary, Henry, Bowles and Troy, Inc.

on behalf of the Council of Insurance Agents & Brokers

February 25, 2014

Chairman Johnson and Members of the Committee, thank you for the opportunity to testify today regarding the terrorism risk insurance program. My name is Bill Henry. I am the CEO of McQueary, Henry, Bowles and Troy, Inc. (MHBT), of Dallas, Texas. My testimony today is on behalf of my firm, as well as the member firms of the Council of Insurance Agents and Brokers (The Council).

MHBT is one of the largest insurance agencies in Texas. With origins dating back to 1925, we have 315 employees in five cities across the State. The Council represents the Nation's leading, most productive and most profitable commercial property and casualty insurance agencies and brokerage firms. Council members specialize in a wide range of insurance products and risk management services for business, industry, Government, and the public. Operating both nationally and internationally, with nearly one in five members with presence outside the United States, Council members conduct business in more than 5,000 locations, employ well over 250,000 people, and annually place approximately 85 percent—well over $200 billion—of all U.S. insurance products and services protecting business, industry, Government and the public at-large, and they administer billions of dollars in employee benefits. Since 1913, The Council has worked in the best interests of its members, securing innovative solutions and creating new market opportunities at home and abroad.

MHBT and the members of The Council believe that terrorism risk protection is an issue of utmost importance and a critical element in our Nation's efforts to be prepared for threats of terrorism and the aftermath of terrorist attacks. The Members of this Committee have been leaders in this effort and we commend you for all of your hard work, including the adoption of the Terrorism Risk Insurance Act (TRIA) in 2002 and the extensions of the Terrorism Risk Insurance Program (the Program) under the Terrorism Risk Insurance Extension Act of 2005 (TRIEA) and the Terrorism Risk Insurance Program Reauthorization Act of 2007 (TRIPRA).

As we near the December 31, 2014, sunset of TRIA's reauthorization, we are already seeing market reaction to the possibility that the Program might not be extended. Commercial policies usually run for twelve months or more, and policies being placed today that run past December 31 of this year contain exclusions for terrorism risk if the Program is not extended. I anticipate that this will cause problems for long-term construction projects, workers compensation, and other coverages as the end of the year draws closer.

Although we understand and appreciate the need for a careful and deliberative process, the facts make clear that the Program has been a success in stabilizing the terrorism risk insurance market, enabling insurers to provide affordable terrorism insurance to policyholders across the country. Moreover, we know the effect that the absence of the Federal backstop has on the marketplace. Therefore, we urge you to take quick action to reauthorize the Program to avoid any negative repercussions resulting from the lack of affordable coverage.

TRIA Has Stabilized the Terrorism Risk Insurance Market, Preventing Economic Destabilization, and Providing an Orderly Structure for Covering Terror Risks

It has been more than a decade since thousands of our fellow citizens, our friends, colleagues and family members, were killed in the September 11, 2001, terrorist attacks. For many Council members, the loss was personal, and our industry lost many good people that terrible day.

One of the most important of the many steps that Congress has taken to protect Americans from the effects of terror attacks was the enactment of TRIA in 2002, and extension of the Program in 2005 and 2007. Passage of TRIA was critical for individual businesses and for the economy as a whole. Although the spotlight was on the insurance industry's capacity to withstand further terror attacks and to cover terror risks going forward, the national risk was—and is—much broader. Because insurance provides individuals and businesses with the ability to take risks essential to the functioning of our economy, constraining that ability would be economically devastating. The impact of the loss of insurance coverage on the economy and jobs would be significant in the best of economic times. Its effects would only be exacerbated today, as we continue the sluggish recovery from the Great Recession.

TRIA has prevented the economic devastation—the loss of economic activity and the loss of jobs—that would have occurred in its absence. Indeed, not only have Federal funds provided by the TRIA "backstop" never been tapped and not one taxpayer dollar spent, the program has proved to be an unqualified success in stabilizing the insurance markets, allowing insurers to provide much-needed terrorism coverage to consumers at prices they are able to afford. TRIA is not about protecting the balance sheets of insurers and brokers—it is about protecting commercial policyholders and creating and sustaining a national economy that encourages investment and development—and American jobs.

When TRIA was originally adopted in 2002, many of us assumed that the private sector would be able to create a market for terror insurance coverage and the Federal program would be a stop-gap measure to ensure stability while that market developed. Since that time, however, it has become clear that the private sector—insurance and reinsurance companies, the capital markets and rating agencies—has a very limited ability to insure and rate terrorism risks that are only questionably quantifiable, totally unpredictable and, essentially, impossible to underwrite. This is further exacerbated with respect to coverage of nuclear, biological, and radiological risks (NBCR), for which coverage is essentially nonexistent even with TRIA in place.

Given these realities, the members of The Council believe a long-term solution to the terrorism insurance crisis is essential and that the Federal Government will continue to have an important role to play in terrorism risk coverage for the foreseeable future. The insurance market needs some level of stability and predictability. The prospect of TRIA's demise—or the uncertainty that would come with periodic renewal or extension of the program every few years—is not viable for the long-term. Failure to implement a long-term or, ideally, a permanent fix before TRIA expires at the end of the year will not only vastly decrease risk transfer options, it will expose the U.S. economy to potentially devastating uninsured economic loss in the event of another catastrophic terrorism attack.

The issue before Congress, then, is not whether the Government will be the insurer of last resort in the event of a terrorist attack, but rather whether the Government will work with the insurance industry to thoughtfully and deliberately develop a plan before an attack to maximize private sector coverage of the massive damages that will result from a terror strike, as opposed to reacting in crisis mode after an attack occurs. We know the Federal Government will step in to provide assistance after a terrorist attack, particularly if there is insufficient private sector relief available. We are all on the hook as taxpayers when tragedy strikes our fellow citizens. TRIA, however, brings the private insurance market into the equation with the financial support and organizational expertise the industry has to offer: direct contribution through upfront premium payments, relief delivery through established claims processes, and a repayment mechanism through policyholder surcharges after the event. Thus, it is not a question of whether the Federal Government will pay, but rather whether the Federal Government will work with the insurance industry to ensure that the preparation and response to a terrorist attack is handled in the most efficient and cost-effective way possible. Better TRIA than FEMA.

Insurance Brokers Support TRIA Because Terrorism Coverage is Critical for Commercial Policyholders

The role of insurance agents and brokers (producers) in general, and Council members in particular, is to help our clients manage risks and secure the insurance coverage they need to protect them from the risk of loss. We primarily serve the needs of commercial insureds, who are the major policyholders of terrorism risk insurance. As the insurance experts closest to insurance consumers and the insurance marketplace, we understand our clients' needs and the needs and appetite of the market, and thus bring a unique perspective to the discussion of terrorism insurance coverage. Commercial insureds need terrorism coverage not just for peace of mind, but for their businesses. Indeed, in many cases, purchase of terrorism coverage is mandatory—it is required to obtain a mortgage or financing for new construction, the expansion of a business or a new entrepreneurial venture, sometimes by State laws and regulations, and often by contract. For example, most States prohibit excluding terrorism coverage from statutorily required workers compensation coverage, and many States prevent exclusion of fire caused by a terrorism event from standard fire policies. This affects our clients because if insurers cannot provide such required coverage, they will simply pull out of the market, resulting in less capacity and higher prices for commercial policyholders.

The most important issue for the broker community, therefore, is maintaining consumer access to coverage at a price the business consumer can afford. In order to get this access, we need insurers who are able and willing to provide the coverage. It is clear that they cannot and will not be able to provide terror coverage without a Federal backstop or some other mechanism to cap their exposure.

Let me give you an example: In addition to running MHBT, I serve on the board of Signal Mutual, a mutual insurer that provides workers compensation coverage under the U.S. Longshoreman & Harbor Workers Act. The first members joined Signal in January 1985. (Mutual insurers are not-for-profits whose members are the owners and policyholders of the company.) The first year, we had 5 members contributing $3,000,000 premium. In 2014, we anticipate 240 members in all U.S. ports and nearly all maritime employments and close to $200,000,000 premium.

Signal policies cover workers in over 800 locations along the water for workplace injury. Many of our members are Navy contractors building and repairing vessels. Others are stevedores loading and unloading all the exports from of our country and imports to our country from all over the world.

Without TRIA, Signal would not be able to provide the workers compensation coverage these people need—and that the law requires. Signal buys reinsurance above $5,000,000 per occurrence to protect members for normal losses, as well as for our liability up to the attachments of TRIA for standard terror risk coverage and for nuclear, biological and chemical terror risks. After September 11, we were one of the first to step up and buy reinsurance for our terrorism exposures, despite the huge price increases we faced due to the lack of capacity in the reinsurance markets to cover terror risk. But we had no choice because terrorism losses cannot be excluded under USL&H coverage. Like 2001–2002, reinsurance capacity remains very limited. Without TRIA, I fear that it would dry up—and the limited amount of availability that remains would be prohibitively expensive.

If this happens—if TRIA goes away—the increased costs will be felt in the prices of everything that enters or leaves the country through our ports and in the cost of Navy contracts, as well. This is not about Signal maintaining a huge surplus, or keeping its investors happy and secure. This is about individual businesses, crucial businesses to our economy and our defense, that will be forced to foot the bill—if they can afford it—if the Federal Government makes the mistake of ending the structural support for the terrorism risk insurance market that TRIA provides. (Additional information regarding Signal Mutual and its workers compensation and terrorism risk focus is attached.)

With or without TRIA, Council members will continue to help our clients mitigate their risks with all the best means available. But insurance is an important component in a comprehensive risk management program, and the availability and affordability of terror coverage is a critical issue for our clients and the U.S. economy. We supported enactment of TRIA in 2002 and its extension in 2005 and 2007, and do so again today because of our clients' need for terror coverage, the lack of capacity in the private market, and the high cost of the small amount of coverage that was available absent TRIA. For the same reasons, and because TRIA successfully brought stability to the private market for terrorism risk insurance, the Council believes the creation of a long-term or permanent solution to the terrorism insurance affordability and availability crisis is essential. There is no more important policy issue for Council members.

TRIA Has Been Successful in Providing Capacity and Affordability to the Terrorism Risk Insurance Market

Since its inception in 2002, TRIA has been incredibly successful in providing the commercial property and casualty market, and insurance buyers, with increased terrorism capacity and significantly decreased prices without costing taxpayers one dollar. In addition to providing readily available and affordable terrorism capacity for U.S.-based risks, the program has also allowed the private market to progressively increase its role in coverage terrorism risks through retained terrorism exposures under TRIA.

Coverage that is both available and affordable is directly due to the existence of the Federal backstop. Since TRIA's enactment, as the availability of terrorism coverage has grown and premium prices have dropped, take-up rates for terrorism coverage have steadily increased. A brief history of the terrorism insurance marketplace since September 11 illustrates TRIA's success:

- Prior to September 11, 2001, terrorism risk was considered minimal and coverage for terrorism was generally included at no additional cost in most property and casualty policies.
- After September 11 and prior to the enactment of TRIA, terrorism insurance became almost entirely unavailable, and the small amount that was available was prohibitively expensive. The lack of coverage for terrorism risk at a time when the perceived risk was enormous resulted in uncertainties whose effects rippled far beyond the insurance industry. Even in Dallas and elsewhere in Texas, we had difficulty getting insurance companies to insure workers compensation (for which terrorism risk exclusions are not allowed) for employers with over 50 employees, for example. This pressure eased with enactment of TRIA.
- In the months after enactment of TRIA, the initial pricing for terror coverage was high and the take-up was low.
- Since that time, the purchase of terrorism insurance has been steadily increasing. In 2003, the first full year of the Program, 27 percent of commercial insureds obtained insurance to cover property terrorism risks. That number jumped to 49 percent in 2004 and increased steadily thereafter, remaining in the low 60 percent range since 2009.
- The initial increase in take-up rates and the strong, stable take-up rates in the past 5 years reflects the demand by America's business community for terrorism coverage at commercially viable prices. Statistics show that the average premium rates for terrorism coverage dropped 25 percent between 2004 and 2005, and another 25 percent between 2005 and 2006 thanks to TRIA's "make available" requirements. These price decreases, and the corresponding increase in take-up rates, provided much-needed stability to the market. Affordable terrorism coverage has allowed numerous business transactions that would otherwise have been stalled to go forward, without threatening the solvency of the parties involved or their insurers. Policyholders—the businesses of our economy—have not had to deal with extremely high—and volatile—terrorism insurance costs and have been able to budget for their business plans. And it has not cost the Government anything.
- Statistics also show that terrorism risk is not limited to urban, coastal areas and is not limited to particular industries. Industry reports indicate that the take-up rates are high across the country and across industries, and policyholders are generally willing to purchase terrorism coverage when it is available at an affordable price. For companies with a higher perceived risk, whether due to size, location, industry or other factors, the take-up rates are even higher. According to industry reports, take-up rates are highest in the Northeast and South, followed by the Midwest and West. Within specific industrial sectors, the largest percentage of insureds buying terrorism insurance are in media, education, financial services, health care, tech/telecom, real estate, and transportation. Even companies in the sectors with comparatively low take-up rates—energy and manufacturing, for example—each had take-up rates exceeding 40 percent in 2012. These relatively high rates show not only demand, but that we are making progress toward the public policy goal of encouraging coverage in affected areas and industries. By comparison, in California—where the likelihood of a major earthquake can be better modeled, understood and underwritten—price and complexity have capped take up rates of earthquake insurance at only 11 percent.

TRIA is Still Needed to Ensure Terrorism Risk Insurance Coverage is Available at Affordable Prices

Despite TRIA's success in stabilizing the terrorism insurance market, the basic facts that prompted the enactment of TRIA in the first place have not changed and still require Federal involvement in providing terrorism insurance. This conclusion will be obvious if we consider the following facts:

- First, the threat of terrorism remains unabated and unpredictable. Although we have been fortunate enough to not have had another terrorist attack on American soil (last year's Boston Marathon bombing was never certified as a terrorist act, although some thought it should have been), we know the threats are out there and they are real, so we need to be prepared. And although we think of cities like New York and Washington as the primary targets, I am convinced that at some point, terrorists will try to hit "softer" but meaningful targets in Middle America, too.
- Second, without Federal involvement, reinsurers would be unable to quantify the risk and would have to effectively withdraw from the terrorism reinsurance market. This conclusion was true when TRIA was first enacted, and remains true today. The private reinsurance industry paid about two-thirds of the roughly $33 billion insured losses related to 9/11 claims. After September 11 and prior to TRIA, the reinsurance industry withdrew from the terrorism reinsurance market due to the huge and unpredictable terrorism risk. Today, global reinsurance capacity remains nowhere near the level needed to adequately insure our economy against terrorism risk without the TRIA backstop. Terrorism loses in an attack on a major metropolitan area like Chicago, Los Angeles or Dallas, could be in the hundreds of billions of dollars. Without the TRIA backstop, private reinsurers would be unable to take on this risk. Indeed, even with TRIA backstop now, reinsurers are not meeting the capacity demand of primary insurers for their deductible and coinsurance layers.
- Finally, without the TRIA backstop or adequate reinsurance coverage from reinsurers, primary insurers are reluctant to expose themselves to potentially unlimited terrorism risks. We saw this quite clearly before TRIA was enacted after September 11, and during the months prior to its reauthorization in 2005 and 2007. At that time, primary insurers were including "springing exclusions" in policies that would have voided terrorism coverage beginning on the date of TRIA's expiration. With the possible expiration of TRIA at the end of this year, we are seeing the same thing: primary insurers are again forcing policyholders purchasing coverage that runs past the end of 2014 to accept those springing exclusions in their insurance policies. It is obvious that if TRIA were allowed to expire after 2014, a large percentage of those policyholders who have no choice but to accept those springing exclusions would see their terrorism risks uninsured—and their business plans disrupted or even put to a halt as a result.

Conclusion

Insurance coverage is essential to the smooth running of our economy and to American jobs. Since September 11, 2001, terrorism risk coverage has been an unavoidable element of comprehensive insurance coverage for commercial enterprises across the country. Since TRIA was first enacted in 2002, the terrorism insurance market has stabilized, terrorism insurance coverage has been steadily expanding, and the price of coverage has become more affordable. Thankfully, this has occurred in the absence of any certified terror attacks, and without the outlay of any taxpayer money.

The success of TRIA does not mean the Program is not needed. As we know, terrorism threats facing our country remain significant and unpredictable, the private reinsurance industry still lacks sufficient capacity to address terrorism risks on its own, and primary insurers are still not willing to expose themselves to enormous terrorism risks without charging prohibitively high premiums—unaffordable by the prospective insureds who need the coverage. Thus, allowing TRIA to expire at this time would be a grave mistake, resulting in destabilization of the terrorism risk insurance market, and significant harm to the overall economy. We urge you to work toward swift passage of an extension of the Program and we are prepared to assist you in any way that we can.

Thank you for your consideration of our views.

Attachment

Signal Mutual

Signal Mutual may be the truest form of capitalism and free enterprise at work! As a mutual, Signal is made up of employers directly sharing risk with other employers—because the insurance industry does not want to assume the risk. Back in the mid 1980s, workers comp was extremely hard to underwrite for insurance companies due to market timing and losses. Federal workers compensation (under the United States Longshoreman & Harbor Workers Act) was the toughest of all. Most workers comp is mandated by State law, but USL&H, for maritime employers nationwide, is regulated by the Department of Labor. The benefits are much higher than the State benefits and the losses are much higher and more severe due to the nature of the work . . . loading and unloading ships with heavy & dangerous equipment, building and repairing ships, ports, and any kind of maritime employment around water.

In 1985, all the insurance companies writing USL&H either ceased offering the coverage or their prices went up considerably. Much of the maritime business was forced to self-insure (for the larger employers), go in an assigned risk pool at exorbitant rates, or go out of business. At McQueary & Henry, Inc., we had customers, but no insurance company to write their USL&H. In our search for coverage for customers, we met a London-based company Charles Taylor. Charles Taylor was a manager for Maritime Mutual Insurance companies for marine protection and indemnity (liability for ships) for over 100 years. In the early 1980's, Charles Taylor formed a group self-insured vehicle named Signal Mutual, approved by the Department of Labor. Charles Taylor had been promised a lot of business from various sources through Signal, but it did not develop, so for the first several years, Signal was shelved.

Through a mutual industry friend, we at McQueary & Henry met the people from Charles Taylor and we agreed to begin underwriting USL&H workers compensation for our customers. Due to severely deteriorating market conditions, we were forced to move quicker than we thought and the first members joined Signal in January 1985. The first year had 5 members contributing $3,000,000 premium. In 2014, we anticipate 240 members in all U.S. ports and nearly all maritime employments, and close to $200,000,000 premium. Employees in over 800 locations along the water are covered for workplace injury.

Unlike "for profit" insurance companies like Hartford, Travelers, AIG, Chubb, *etc.,* Signal is a true mutual and not for profit (although we are licensed as a U.S. taxpayer, the norm is to underwrite USL&H workers compensation at cost to the members). There are no stockholders—the mutual is owned by the employer members. The members are business people in privately held companies and public companies. Each member is assigned a rate each year based on occupation and loss history over the past 5 years. Everyone pays premium based on their rate and their individual payroll and at years end, the expenses and the losses are totaled and if Signal runs at a deficit, each member is assessed their percentage of that deficit. Each member secures their payments of premium and assessments with a letter of credit or other acceptable means approved by the DOL. In addition, as a true assessable mutual, the collective balance sheets of each member are at risk if they loss is too large.

Signal buys reinsurance above $5,000,000 per occurrence to protect the members for normal losses, for our liability up to the attachments of TRIA for regular terror events and for nuclear, biological and chemical terror risks. After 9/11, we were one of the first to step up and buy reinsurance for our terrorism exposures and paid a huge price increase. There is no choice as terrorism losses cannot be excluded under USL&H. The capacity was very limited and it continues to be. There is some availability currently, but no one knows what the capacity of the insurance market is for terror attack related exposures if TRIA goes away.

As Signal, our members/customers are among the most "at risk" and the most sensitive to the overall economy of the USA. First of all, our U.S. ports are a prime target for terrorism. Many of our members are Navy contractors building and repairing vessels. Many of our members are also stevedores loading and unloading all the imports and exports of our country from all over the world. If TRIA goes away and our costs escalate considerably, which they most certainly will (assuming reinsurance for terrorism will be available), these cost will translate into the price of everything that enters or leaves the country and also to the Navy contracts.

Unlike a normal insurance company, this is not about a huge surplus for Signal and its investors. This is about individual businesses—crucial businesses to our economy and our defense—which will be writing checks to recover if we have a terrorism event. They will also be writing much larger checks for expenses it the price or availability of terrorism reinsurance goes up considerably—if they can afford it.

Respectfully,

Bill Henry

PREPARED STATEMENT OF VINCENT T. DONNELLY

PRESIDENT AND CEO, PMA INSURANCE GROUP

ON BEHALF OF THE PROPERTY CASUALTY INSURERS ASSOCIATION OF AMERICA

FEBRUARY 25, 2014

Thank you M. Chairman and Ranking Member for inviting me to testify today.

My name is Vincent Donnelly and I am the President and CEO of The PMA Insurance Group (PMA). I am testifying on behalf of PMA and the Property Casualty Insurers Association of America (PCI), which is composed of more than 1,000 member companies, representing the broadest cross section of insurers of any national trade association. PCI members write more than $195 billion in annual premium and 39 percent of the Nation's home, auto and business insurance, epitomizing the diversity and strength of the U.S. and global insurance markets.

Since our inception over 90 years ago, PMA has specialized in the writing of workers compensation insurance across the country. Workers compensation insurance provides wage replacement and medical benefits to employees injured in the course of employment—protecting both employers and employees from harm. Representative PMA policyholders include contractors, manufacturers, health care providers, nursing homes, retailers, schools and universities.

Reauthorization of TRIA is critical to our business and our customers. The private insurance markets are not willing to accept every risk—particularly unpredictable and potentially catastrophic risks like terrorism—and a failure by Congress to reauthorize TRIA or a significant increase in TRIA's thresholds will force PMA and a significant amount of private capital out of high risk markets. Having a terrorism risk insurance plan in place before the next attack protects our country's economic resiliency and security at nearly no cost to the taxpayers. PMA and PCI strongly urge your support for the current version of TRIA.

The Terrorism Risk Insurance Act (TRIA) was enacted in 2002 because our Nation's economic recovery from the tragic events of September 11, 2001 was being impeded by a lack of available terrorism insurance. 9–11 was one of the largest insured losses in history, and faced with such unpredictable and unlimited risk, insurers and reinsurers began to exclude terrorism coverage where allowed, or avoid insuring certain high risk consumers or locations with high concentrations of risk altogether.

TRIA is a bipartisan success story where, in response to the attack against our Nation, Democrats and Republicans came together to enact, and subsequently twice reauthorize by overwhelming votes, a private-sector focused program that has helped the marketplace function exceptionally well, with terrorism insurance coverage widely available and affordable. The Congress wisely chose to put a terrorism protection plan in place that would limit terrorism insurance losses and thereby encourage private investment to return by converting a potentially unlimited catastrophic exposure into a more manageable, still unpredictable but finite exposure that insurers can underwrite. Consumers were also given a guarantee that insurers would "make available" terrorism protection in their policies on the same terms and conditions as the underlying coverage. Construction projects that had stalled got back on track and new projects got started. Employers, even in big cities or near critical infrastructure, were again assured of workers compensation availability.

As Congress revisits TRIA, it is appropriate to inquire whether the program is working as intended or whether additional reforms should be considered. PCI's mission is to promote and protect the viability of a competitive private insurance market for the benefit of consumers and insurers, and our members generally support Government reforms that maximize commercial participation and taxpayer protection. That is why our members support the current terrorism insurance program so strongly—it has done a superb job of bringing in private capital that would otherwise not be made available, with Government involvement only at the most extreme and uninsurable levels. This has been reflected in the terrorism insurance marketplace, where availability and affordability has greatly improved since 9–11, leveling off over the last several years suggesting that supply and demand are currently extremely well balanced. PCI hopes that the Committee will recognize the enormous success of TRIA in providing terrorism risk coverage in a fiscally responsible manner that protects our country's infrastructure while greatly reducing the need for Government assistance after a catastrophic terrorist attack.

TRIA is Fiscally Responsible

TRIA does an excellent job of keeping commercial insurers participating in the terrorism insurance market, thus protecting taxpayers from economic loss due to terrorism. Unlike many other Government insurance programs, under TRIA, private sector insurers are on the hook for all but the most catastrophic terrorism losses. Commercial insurers pay losses within the trigger and through their very high annual TRIA deductibles and co-pays, keeping the Government at a super-reinsurance level—essentially only for catastrophic loss limits that the private market is unwilling to insure on its own. The Federal Government currently spends an average of $12.1 billion annually on disaster assistance where private sector insurance coverage does not exist. Keeping the private sector largely responsible for future terrorism losses instead of the Government after a national security interdiction failure protects the taxpayers and Congress alike from the political pressure to parachute disaster assistance for innocent victims after a tragic terrorism event.

The marketplace pays for these loss limits through a post-event surcharge (a "terrorism loss risk-spreading premium") if TRIA is triggered. This post-event payment structure is common for State insurance guaranty funds and several Government residual markets, and is particularly appropriate for protecting against extreme but rare and unpredictable catastrophic risks where accumulating and segregating the necessary capital in advance would be inefficient. Under TRIA, in the event the Federal backstop is triggered, Treasury has the opportunity to recoup Government payments from the marketplace, in the form of a post-event surcharge on all property-casualty insurance policies providing coverage in TRIA-covered lines. The recoupment is currently mandatory when the marketplace aggregate insured losses are $27.5 billion or less (with terrorism loss risk-spreading premiums of 133 percent of Government assistance within that amount) but is discretionary when losses are above that amount. Taken together, these features make TRIA an extraordinarily fiscally responsible program.

Impact on Workers Compensation

Workers compensation provides statutory benefits, including lifetime medical benefits, rehabilitation services, wage replacement payments, and extensive survivors' benefits to spouses and dependent children. These "long tail" benefits can run for years or decades. Medical benefits are unlimited and can total in the millions of dollars for a single catastrophic injury. Under State law, coverage for injuries resulting from acts of terrorism cannot be excluded from workers compensation policies, including the terrible injuries that would occur from a nuclear, biological, chemical, or radiological (NBCR) attack. As the marketplace experienced in the year following the terrorist attack of 9–11, without TRIA, adequate reinsurance coverage for terrorism can be very difficult to obtain, especially for high profile risks, regions with high value accumulations or NBCR attacks. Without adequate reinsurance, many insurers could be forced to exit portions of the market, capacity could be strained potentially causing price spikes, and the immense scale of potential unlimited terrorism losses for workers compensation insurers could impair the ability to pay the claims of injured workers. While reinsurance is somewhat more available at the moment than it was immediately after 9–11, that won't always be the case. In the future, particularly following the next global catastrophe, and without a terrorism insurance plan in place, there will always be gaps in coverage. The rating agency A.M. Best last year identified several insurers for potential downgrades if TRIA were not renewed, mostly workers compensation carriers. The resulting restriction of high quality capital for America's businesses would be a significant impediment to economic recovery and jobs growth.

The Importance of Retaining TRIA's Current Loss Limits

Many of the reforms proposed to increase private sector participation and reduce taxpayer exposure under TRIA have been rejected in the past by Congress because they would weaken the loss limits for insurers and thereby reduce the willingness of private capital to invest in or cover terrorism risks. In particular, the key thresholds of TRIA that turn terrorism into a more manageable risk for insurers to underwrite are the deductible, co-share and trigger. Every insurer limits its risk to a probable maximum loss exposure that it can responsibly manage and still fulfill its commitments to policyholders. If TRIA is reauthorized with excessively high thresholds—deductibles, co-shares, or triggers, then the retained risks for insurers, would exceed the probable maximum losses they can retain and they would be driven out of the market. Congress would thus reduce insurance availability.

Deductibles: A high TRIA deductible means a greater proportion of the terrorism loss is paid out of an insurer's surplus, putting more of its capital at risk. An insurer's deductible is 20 percent of its prior year earned premiums from TRIA covered lines of insurance. No Federal payments are extended under TRIA unless both the program trigger and an insurer's deductible have been exceeded, and even then only for a portion of the insurer's certified losses exceeding its deductible.

The current 20 percent TRIA deductible is greater than 10 percent of company surplus for 40 percent of all TRIA insurers (333 companies). Those companies are vulnerable to A.M. Best downgrades and precarious company stability due to the negative impact to their surplus at a 20 percent TRIA deductible. Very few companies of any kind would voluntarily put such a large portion of their capital at risk to a single threat, but insurers are required to do so under the current TRIA law. Increasing the deductible further would drive many insurers out of the market; they simply would be unable to responsibly underwrite at current capital levels with that sort of unavoidably large terrorism risk on their books. Many business consumers are only able to purchase insurance coverage from a carrier with at least a certain rating; capacity would be particularly constricted for these companies. The effect would be anti-competitive, leaving fewer insurers providing less terrorism capacity at a higher price than is presently available, where coverage would be available. This is counter to TRIA's goal of bringing stability to the market and ensuring that adequate capacity exists to meet the market's need.

Co-Shares: The impact on surplus is only made worse by the insurer's TRIA retention (coinsurance share) of an additional 15 percent of losses above its deductible. While an insurer at least knows what its maximum deductible would be in a catastrophic event, the co-share is limited only by the $100 billion annual program cap. Since workers compensation by law requires unlimited coverage for insured risks, a 15 percent co-share of a $100 billion loss would threaten the solvency of almost every insurer. For example, a medium sized insurer with $1 billion in annual earned premiums might underwrite to a probable maximum loss of $100 million; but if the terrorists go after that insurer's policyholders causing $100 billion+ of insured losses, the insurer would pay a $200 million deductible and a nearly $15 billion co-pay. While insurers conduct extensive modeling to diversify and mitigate their risks, terrorism attacks are not random and the 15 percent co-pay in TRIA already potentially dwarfs the solvency of most insurers, undermining the certainty that the program otherwise provides. Increasing this number further would create a severe disincentive to providing future coverage.

Particular Harm to Small- and Medium-Sized Insurers of Weakening Changes to TRIA

Weakening TRIA's loss limits would be particularly counterproductive because it would make it more difficult, and in some cases impossible, for small- and medium-sized insurers to write property casualty insurance in TRIA covered lines, thereby constricting available capacity and affordability. Ninety-eight percent of companies writing TRIA lines of insurance are small or medium-sized. These insurers write over 47 percent of the TRIA-covered premium in the Nation, including many specialty lines and niche businesses that might otherwise find little coverage availability.

Because of their smaller capital base, smaller insurers are less able to absorb large losses. For example, a company with $5 billion in surplus is better able to withstand a loss of $50 million than a company with $100 million in surplus. Larger companies can also more readily access capital markets. A 10-percent or greater surplus hit to a small or medium-sized company may very well be a company-closing event, or more likely risk a downgrade by credit rating agencies below the level required to retain many commercial accounts. In underserved niche markets, fewer players translate into availability issues and higher rates. Indeed, the rating agency A.M. Best has issued a briefing paper suggesting that, even at the current 20 percent deductible, a number of small to mid-sized companies may be subject to ratings downgrades. The only way many of them could avoid such downgrades is to exit some TRIA-covered lines entirely, since the TRIA "make available" requirement prevents them from being able to limit their terrorism exposure in any other way.

The impact on surplus is only made worse by the insurer's TRIA retention (coinsurance share) of an additional 15 percent of losses above its deductible. Because smaller companies have less capital to draw on than other writers, coinsurance places a greater burden on smaller insurers. Again, all insurers must take care not to exceed their probable maximum loss limits, but increasing the TRIA co-share would cause them to reach those limits sooner. To avoid that, some will be compelled to exit markets or lines of business, which reduces competition and compromises TRIA's ability to achieve its intended purpose.

Triggers. The level of the trigger determines whether and when the Government's obligations arise. The current $100 million trigger means that no insurer will be reimbursed unless the total industry TRIA losses exceed $100 million. Because the trigger is not indexed to an individual insurer's size, a higher trigger makes much less likely that smaller and mid-sized insurers will realize the benefits of the program that allow them to remain to continue writing coverages the marketplace and the economy need. In 2012, roughly two-thirds (67 percent) of all TRIA writers had surplus less than the current $100 million program trigger, all of which are small or medium-sized companies. For a large percentage of insurers, the $100 million trigger already exceeds their 20 percent deductible. Severe increases in TRIA's trigger would discriminate against smaller and mid-size insurers, forcing them to exit risks or markets altogether where adequate reinsurance is neither available nor affordable.

When the greatest possible number of strong, viable competitors serve the market insurance consumers have more choices, prices are more competitive, and product innovation is enhanced. If TRIA is discontinued, or reauthorized with excessive thresholds, it will become an unviable program for small and mid-sized insurers. Overall availability and affordability will be greatly reduced—not only for terrorism coverage but also for other commercial lines of insurance as well. This clearly would be bad for consumers and would undermine TRIA's intended purpose.

Potential Technical Changes

PCI and its members strongly support reauthorization of TRIA in its current form. It is one example of an extremely effective and cost-efficient disaster preparedness plan. However, if Congress decides to make changes to TRIA, PCI would suggest certain technical clarifications.

Consumers rely on insurers to pay insured claims in a timely manner. Insurers in turn rely on TRIA's certification process to determine whether a terrorist attack is considered an act of terrorism, and thus whether terrorism coverage applies. The Boston Marathon attack exposed flaws in the TRIA certification process. State laws generally require timely payment of claims. However, there is no Federal requirement that the Treasury Secretary make a determination to certify an act of terrorism within any particular time period. In many cases, businesses would not know if their losses were covered until a certification decision was made (if ever), and insurers would have to make claim payment decisions without knowing whether an event will qualify as a certified event. Consumers and insurers are thus both disadvantaged by the uncertainty, increasing the likelihood of litigation and forcing insurers to either make inappropriate claims payments or potentially violate State unfair claims practices laws and/or State bad faith laws. TRIA currently provides unreviewable and nondelegable discretion by the Treasury Secretary to certify a terrorist event for TRIA purposes, in consultation with the Attorney General and the Secretary of State. Finalizing liability and business interruption claims could take months, and one of the three Government officials required for certification could be unavailable for a time, pushing the timing of the Government certification process far past the needs of consumers and insurers.

There may be value in statutory clarification of the program's treatment of nuclear, chemical, biological and radiological (NBCR) risks and cyber risks. Treasury's current interpretation is that the Federal backstop covers these losses to the extent insurers provide the coverage, but TRIA's requirement to make coverage available applies only to the extent that NBCR and cyber coverage for losses arising from nonterrorism causes are covered in the underlying policy. PCI believes that is the correct interpretation but it may be appropriate to consider whether and how to make this clear in the statute.

There have also been suggestions to clarify the statutory ambiguity as to whether multiple events occurring in the same year, such as the four different plane attacks on 9–11, none of which independently meets the trigger, can be aggregated to trigger the program collectively. Treasury appears to read the current statute as meaning that the program is not triggered unless a single act of terrorism results in losses that exceed the $100 million trigger. However, this reading would render the current $5 million event certification threshold meaningless. Other observers, including the Congressional Research Service (CRS), read the statute as permitting aggregation of loss events in a program year that exceed $5 million. PCI believes that Congress did not make a mistake in retaining the $5 million threshold and the better interpretation is that aggregation is permitted. Multiple copycat terrorist bombings in a year, even if each is just under $100 million in losses, is clearly the type of exposure that can rattle the marketplace in ways that TRIA was successfully designed to prevent. However clarification of this issue would create more underwriting certainty, benefiting both consumers and insurers.

PCI will be pleased to work with the Committee on ways to address these technical, but important issues.

The American People Support TRIA

Last year, PCI surveyed voters and conducted focus groups to learn what voters think about how their Government protects them from the effects of terrorist attacks. Among the key findings were:

- A majority of voters, 72 percent, agree that responsibility for the costs from injuries to workers and property damages from a terrorist attack should be a combination of the Federal Government and private insurance companies.
- A majority of voters agree that it is important for America's economy to have a plan in place before an attack to ensure large projects can be built in a timely, cost effective manner.
- 90 percent of the participants agree that the Federal Government should be at least in part responsible for protecting against losses from terrorist attacks against the United States.
- A majority of voters, 64 percent agree that it is difficult for insurance companies to provide affordable terrorism insurance because of the randomness and difficulty in predicting the likelihood or magnitude of terrorist attacks.
- A rural-urban divide does not exist; 68 percent of voters understand the national economic implications of a terrorist attack.
- 67.6 percent of voters favor continuing the Terrorism Risk Insurance program.

The study showed unmistakably that Americans want their Government to have a risk management program in place to protect the U.S. economy against the effects of a catastrophic terrorist attack and that both the commercial insurance industry and the Government have important roles to play in such a plan.

Conclusion

It is essential for America's economy to have a terrorism risk insurance plan in place to ensure large projects can be built in a timely, cost effective manner after an attack occurs which would help keep the economy stable and provide jobs. Having a terrorism risk insurance plan in place helps thwart the devastating economic impacts of a terrorist attack and protects our national security. TRIA is a fiscally responsible program that has cost the taxpayers almost nothing in its 11-year existence, while protecting economic resiliency. It also reduces the need for additional Government catastrophic response programs that can be far more costly after the fact. PCI strongly supports reauthorization of the current TRIA program with thresholds that will continue to encourage insurers of all sizes to provide private sector capital to compete and ensure availability of terrorism coverage. PCI also supports efforts to clarify TRIA's application and coverage, particularly with respect to improving the terrorism event certification process.

PREPARED STATEMENT OF WARREN W. HECK

CEO and Chairman of the Board, Greater New York Insurance Companies
on behalf of the National Association of Mutual Insurance Companies

February 25, 2014

Introduction

The National Association of Mutual Insurance Companies (NAMIC) is pleased to provide testimony on the Terrorism Risk Insurance Act (TRIA) and the private market for terrorism insurance.

NAMIC is the largest and most diverse property/casualty trade association in the country, with 1,400 regional and local mutual insurance member companies on main streets across America joining many of the country's largest national insurers who also call NAMIC their home. Member companies serve more than 135 million auto, home and business policyholders, writing in excess of $196 billion in annual premiums that account for 50 percent of the automobile/ homeowners market and 31 percent of the business insurance market. More than 200,000 people are employed by NAMIC member companies.

It is our firm belief that in the absence of a terrorism loss management plan such as TRIA, no self-sustaining private market for terrorism risk coverage is likely to develop. However, the existence of TRIA allows a viable private market to function for a difficult peril which involves strategic human behavior and represents a dynamic threat that is intentional, responsive to countermeasures, and purposefully unpredictable.

Any discussion of the private market for terrorism insurance must start from the understanding that the TRIA program was a well-designed mechanism to encourage the private sector to put its capital at risk for losses that result from what amount to acts of war—which have always been considered uninsurable events with either an implicit or explicit expectation that financial responsibility resided with the governments involved. Having learned the lessons of 9/11, most insurers are not likely to offer terrorism coverage in a fully private market.

In fact, it is the unique structure of the program's recoupment mechanism that takes losses that could render a single company insolvent and spreads them throughout the private sector and over time. This mechanism allows for a large and temporal transfer of risk that would not occur in a fully private market, but in the end does utilize private capital and protects taxpayers.

NAMIC remains committed to ensuring that the program be designed to adequately protect taxpayers and maximize private sector capital in the market for terrorism insurance. That said, in considering changes to the present system, we would caution against adopting solutions in search of problems. In fact, alterations that increase the exposure to individual companies could have the unintended consequence of reducing overall capital in this market. Through TRIA, the private sector already has a tremendous amount of capital involved in the terrorism risk insurance market and under current law every penny the Federal Government pays out may be recovered.

TRIA Structure Designed for Individual Company Participation

Discussions surrounding the private terrorism risk insurance market tend to focus on aggregate numbers—*i.e.,* how much market capacity exists, industry exposures, *etc.* However, the design of the TRIA program focuses on something entirely different and, in our view, more appropriate: the individual company. The program is structured this way to take into account the unique risk posed by terrorism and the fact that losses are not likely to be spread evenly among a large number of insurers even in a catastrophic event.

The current program requires all insurers selling covered lines to offer terrorism coverage, compelling many insurers that had previously exited that market to return and dramatically reducing the amount of potentially uninsured losses in the event of an attack. In return, the Federal mechanism for risk-sharing provides more definitive loss parameters for each company; specifically, the individual company retention (20 percent of the prior year's direct earned premium for covered commercial lines) and the co-pay (15 percent of all losses above the individual company retention). By placing a ceiling on individual company terrorism exposure, insurers have the benefit of knowing their maximum possible losses, allowing them to make coverage available and price accordingly.

It is important to note that simply because an individual company's losses are capped, this does not mean that the private sector participation ends there and the Federal taxpayer pays for the rest. Rather, TRIA works through its recoupment mechanism to take those losses and spread them back throughout the private sector and over time. In this way, TRIA acts as a shock-absorber for the U.S. economy to reduce the financial impact of a jarring terrorism event.

By law the Federal Government must recoup the difference between insurers' total costs and the industry aggregate retention of $27.5 billion (assuming the total cost of the event with Government payments is $27.5 billion or higher) over time through surcharges on every policy covered by TRIA. Since 2007, the Government must actually recover 133 percent of this mandatory recoupment. In the event the insurers' total costs exceed $27.5 billion, the Government can still recoup whatever money it pays out, but this is at the discretion of the Treasury Secretary. The recoupment is done through an assessment on every TRIA-covered, commercial line policy sold in the United States over time. The initial outlays of the Federal Government, which are so important to maintaining an individual company's solvency, are in fact borne by private sector insurers and their commercial policyholders (and paid back with interest for the mandatory recoupments). ***Taxpayers are completely protected under TRIA.***

The structure of the program is important—it is why questions of overall industry capacity can distract from the serious concerns about terrorism risk that remain for individual insurance companies. Even in a catastrophic event, the losses are not likely to be spread evenly among a large number of insurers. This is especially so in the case of terrorism because perpetrators have the ability to precisely target particular properties or assets. Hence, a single terrorism event could affect insurance companies with similar books of business in very different ways: one company might suffer no losses from the event, while another company could suffer losses sufficient to threaten its very existence. The TRIA program—through the mechanism of initial Federal outlays recovered through recoupment—allows this "bet the company" risk to be spread throughout the private sector and over time in a manner that cannot be duplicated by the private sector alone.

Altering the Program

Most insurers would likely not offer terrorism coverage in the absence of a Federal risk-sharing mechanism like TRIA. Recent research by Aon shows that more than 85 percent of insurers will no longer insure terror risk if the Federal program went away.[1] Additionally, State insurance regulators indicate that they have not seen evidence suggesting that the insurance marketplace is capable or willing to voluntarily take on a substantial portion of the risk of providing coverage for acts of terrorism in the absence of the program. It was only with a program in place that put some structure around an ill-defined catastrophic risk that the private sector was able and willing to participate at current levels. We cannot hastily conclude that because the private sector can handle a portion of the risk, it could raise enough capital to handle all of it. Similarly, assuming that a substantial diminution of the Federal Government's role will necessarily result in private market innovation that has heretofore failed to materialize is unwise. Although individual market players may indicate willingness to take on greater exposure in the abstract, the private market has consistently demonstrated an unwillingness to accept a significantly larger portion of this potentially devastating risk, in particular when it comes to offering affordable limits to protect the solvency of the workers' compensation insurers.

One reason to doubt that reinsurers would provide additional terrorism coverage where and when primary insurers needed it is that reinsurance capacity would likely be severely constrained following a large-scale natural catastrophe, such as a major hurricane striking the Gulf or Atlantic coasts. The U.S. commercial insurance market would be right back to where it was following 9/11 with limited availability and no guarantee that the capacity and willingness to take on terrorism exposure would return.

Additionally, in seeking to accomplish the goal of increasing private sector participation in the terrorism insurance market, it is important to recognize the presence of other risks that need to be insured in our dynamic economy. That capacity cannot be exposed beyond a reasonable level without failing in its primary purpose—supporting the economy by protecting against nonterrorism related losses and events. In the event of a major attack, substantially depleted reserves and surpluses, and insolvencies could mean that policyholders of noncovered lines could go unprotected. A company that engages in business that endangers its ability to pay claims on existing or future policies is violating its duties to its policyholders.

An important example of this issue is the workers' compensation market. Workers compensation writers are not permitted to exclude any peril from their coverages and are particularly susceptible to having highly concentrated losses in the event of a major terrorist attack. In the absence of a private/public, risk-sharing mechanism workers' compensation carriers will retreat from having highly concentrated losses in the event of a major attack. There would almost certainly be a simultaneous and significant increase in the cost of these policies and decrease in their availability for employers based in the major metropolitan areas and industries involved with, or adjacent to, symbols of America which are currently covered by private carriers. The only way a workers compensation writer could eliminate its terrorism exposure in high-risk markets would be to completely withdraw from those markets. In the absence of the TRIA program, or an increase in the deductibles and/or co-pays, we would expect to see a shift from the private workers' compensation writers to the insurer of last resort—usually a State fund or residual market pool, causing ripple effects throughout the business community.

Trigger Level

Finally, NAMIC would caution policymakers not to assume that they can guarantee increased private sector participation through statutory changes. Increasing the nominal amount of private sector involvement in the current TRIA structure does not automatically translate into an increase in private sector capital in the marketplace. As with increased company retentions, altering trigger levels may cause market participants—particularly small- and medium-sized companies—to exit, thereby reducing total private capital. An effective terrorism loss management plan depends on participation by insurers of all sizes and structures.

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[1] "Response to U.S. Treasury and President's Working Group: Terrorism (Re)Insurance, AON, September 2013, page 9. *http://www.aon.com/attachments/risk-services/2013-Aon-Response-to-Presidents-Working-Group.pdf.*

The rationale given by those who favor raising the event trigger and/or the company deductibles and co-payments is that such modifications would increase the share of terrorism risk borne by the private insurance market while reducing the Government's exposure. In fact such measures would result in a smaller private insurance market, which would further expose the Federal Government to greater costs in the form of post-disaster assistance to terrorism victims that were left uninsured or underinsured due to the decrease in coverage availability and affordability brought about by ill-considered revisions to the program.

Consideration of just one proposed change in particular is illustrative of this dynamic. It has been suggested that raising the event "trigger level" will further the goal of taxpayer protection. As a practical matter, however, a higher trigger would do nothing to reduce taxpayer exposure in the event of an attack.

Consider the below comparison between two trigger levels $100 million and $1 billion. Because of the recoupment provision under the law, the Federal Government is required to recover 133 percent of any money it spends for losses below $27.5 billion, and is permitted to recover 100 percent above that level at the discretion of the Treasury Secretary. Consider a $500 million loss scenario under the two trigger levels:

$500 M Event	**$100 M Trigger**	**$1 B Trigger**
Program Triggered?	Yes	No
Insurer Paid Losses	$160 M	$500 M
Initial Government Outlays*	$340 M	$0
Mandatory Recoupment (Private Sector Loss Sharing)	$452 M (133% X $340 M)	$0
Net Gain/Loss to Fed. Government	**+ $112 M**	**$0**

* Worst Case Scenario - Losses equal 20% of 500 million (deductible) plus 15% of the remainder (co-share)

While raising the trigger level would in some circumstances reduce initial Government outlays, we can see that, ultimately, the cost to the taxpayer is not reduced. Nor would raising the trigger level necessarily impact initial Government outlays, because the individual company deductibles and co-payments of the insurers involved could exceed the event trigger by orders of magnitude. Consider the same scenario with a single impacted company with an individual retention level of $1 billion:

$500 M Event	**$100 M Trigger**	**$1 B Trigger**
(Company deductible =$1 billion)		
Program Triggered?	Yes	No
Insurer Paid Losses	$500 M	$500 M
Initial Government Outlays	$0	$0
Mandatory Recoupment (Private Sector Loss Sharing)	$0	$0
Net Gain/Loss to Fed. Government	**$0**	**$0**

Here, the trigger level has no impact. Where it does have a very significant impact is in cases involving smaller or regional insurers. Consider the same scenario for a single company with a retention level of $100 million.

$500 M Event	$100 M Trigger	$1 B Trigger
(Company deductible=~$100 million)		
Program Triggered?	Yes	No
Insurer Paid Losses	$160 M	$500 M

A $500 million loss could easily render such a company insolvent. Potential exposure like this would cause these companies to take a long look at their underwriting and risk concentrations.

Indeed, the only impact of raising the trigger would be on smaller, regional, and niche insurers whose deductible—and even total exposure—falls under a level set too high. This situation would create a "bet-the-company" risk for these companies and would likely force them to constrain coverage or leave certain markets entirely. Because it is not at all clear that remaining companies could or would provide this missing coverage, the probable effect of a higher trigger would be to reduce the amount of total private capital allocated to terrorism risk.

In short, raising the trigger does nothing to reduce taxpayer exposure while simultaneously having the potential to drive private capital from the market.

Certification of Terrorist Attack

Treasury has taken steps to streamline and facilitate certification; however, it is complex and difficult process requiring extensive investigation and correlation of information from multiple sources. Delays in certification raise issues for insurers, who are required by State law and regulation to make prompt payment of claims. NAMIC believes that Congress should facilitate expeditious information exchange between various national and international agencies to provide Treasury with information in a timely manner.

Congress could also provide a certification protocol with appropriate timelines to ensure that all parties understand the process, their duties and obligations, and the applicable timeframes. Also, requiring an affirmative determination on certification could help to strengthen the predictability of the process.

An efficient and effective certification will benefit the taxpayers, insurers and their insureds.

Conclusion

Private insurance companies, including mutual companies, are return-seeking operations. Therefore, if they believe there is an opportunity to earn an economic return and it is possible to do so in accordance with an overall successful business model, then they will. In other words, if there was money to be made in insuring against terrorism risk, coverage would be offered without Government intervention. If such were the case, the companies would be arguing for less—not more—Government intervention to increase their earning potential. The fact that they are uniformly not doing so and in fact suggesting that without the TRIA program private coverage would not expand and instead contract, is telling.

Under the current TRIA program the private sector is heavily involved in absorbing the losses from a terrorist attack against the United States. Ultimately, it is responsible for covering all the losses at the discretion of the Treasury Secretary.This private sector involvement addresses the needs of victims and limits the need for Government intervention—thus taxpayer exposure—post attack. In contemplating altering the current program, it is important to identify the specific problems that need to be addressed.

In the end, the purpose of the program is not to protect insurers, but to make sure that the economy can recover in as orderly a fashion as possible from a terrorist event. In order to encourage private sector involvement in the terrorism insurance marketplace—and thereby protect and promote our Nation's finances, security, and economic strength—we should maintain a long-term, well-functioning terrorism loss management plan. Fortunately, the current TRIA program has proven to be just such a plan.

PREPARED STATEMENT OF DOUGLAS G. ELLIOT

PRESIDENT, COMMERCIAL MARKETS, THE HARTFORD FINANCIAL SERVICES GROUP
ON BEHALF OF THE AMERICAN INSURANCE ASSOCIATION

FEBRUARY 25, 2014

Chairman Johnson, Ranking Member Crapo, and Members of the Committee, thank you for the opportunity to appear before you today on behalf of The Hartford Financial Services Group (The Hartford) and our property-casualty insurance trade association, the American Insurance Association (AIA), to discuss the important issue of terrorism risk insurance. My name is Doug Elliot and I am President of Commercial Markets for The Hartford. Founded over 200 years ago, The Hartford is one of our Nation's oldest insurance companies, among the largest commercial property-casualty insurers, and an insurance partner to over one million small businesses across the United States.

As president of The Hartford's commercial property-casualty lines business, I am responsible for the company's small commercial, middle market and specialty casualty businesses, as well as group benefits. In this capacity, I believe that I can offer an important perspective on the unique challenges of insuring terrorism risk, the market-stabilizing effect of TRIA, and the adverse consequences should Congress fail to maintain the program for the foreseeable future.

Most importantly, as we approach TRIA's expiration at the end of this year, the industry understands and welcomes a healthy reexamination of its merits. TRIA has been a successful and important economic tool. It establishes the right public-private balance of responsibilities and loss-sharing for the United States, promoting national security and an orderly economic recovery in the wake of catastrophic terrorism. While we do not support any changes to TRIA's public-private partnership, we would be happy to work with lawmakers to evaluate the feasibility of changes or modifications designed to improve the overall efficacy of the Act. But in this process, we propose that any potential modifications to the program should be assessed in light of the balance the Act currently achieves. A number of proposals that have been discussed could—in the name of increasing private market capacity for terrorism risk—actually lead the industry to a tipping point beyond which individual insurers would need to make difficult decisions to safeguard a company's financial condition instead of maintaining the current level of exposure to catastrophic terrorism risk. This could result in upsetting the public-private partnership and undermining important sectors of the economy that depend on the availability of terrorism risk insurance, such as construction, real estate, manufacturing, infrastructure and small business generally.

The Insurance Industry's Response to September 11, 2001

It has been more than 12 years since the tragic attack of September 11, 2001. That event forced all Americans to confront directly the previously unforeseen realities associated with a catastrophic terrorist attack on U.S. soil—quite literally, to face a new form of war. Despite the unanticipated nature of the event, The Hartford and other insurers responded to September 11 claims in an unwavering manner and without a single dollar of Federal assistance.

However, the devastating economic consequences of the attack forced insurers and other businesses to re-examine the nature of terrorism-related risks, as well as to review how such risks were being spread and managed.

In addition to the incalculable cost of almost 3,000 lives, in today's dollars, claims paid by insurers to their policyholders from September 11 eventually totaled some $32.5 billion dollars—$42.1 billion in 2012 dollars.[1] The Hartford's share of this loss was approximately 3 percent to 3.5 percent, as we helped our policyholders recover from the tragic loss. Of course, a large portion of the insured industry loss was effectively reinsured, and the reinsurance industry honored its obligations.

Unfortunately, in the aftermath of the attack, the reinsurance markets withdrew new capacity and the reinsurance market for terrorism evaporated. Without the ability to spread and diversify these risks globally through reinsurance and with no ability to price the risk of terrorism, insurance companies were unable to provide adequate terrorism coverage to commercial policyholders. The effects of this chain of events trickled down to lenders and the construction industry, putting a significant drag on the economy. To support the economy and allow private markets to stabilize, Congress stepped forward in bipartisan collaboration and passed TRIA. TRIA provides a Federal backstop to insurance companies for large certified terrorism events above a $100 million loss, while requiring insurers to "make avail-

[1] Source: Insurance Information Institute, 2012 dollars excluding Victims Compensation Fund.

able” (offer) terrorism insurance to commercial policyholders for such coverage as workers’ compensation, business interruption and property insurance.

Under the current program, insurers are required to pay insured terrorism losses equal to 20 percent of their entire premium for covered commercial property-casualty lines of business before the Government steps in to pay its share of loss. Even then, TRIA requires each insurer to pay 15 cents on every dollar of loss above its deductible. TRIA requires the private sector to absorb at least $27.5 billion in insured terrorism losses before taxpayers are exposed, and then provides a recoupment mechanism to permit the recovery of Federal dollars that are expended up to the program’s annual $100 billion cap.

By virtue of this post-event, public-private “shared loss” mechanism that preserves significant industry “skin in the game” and only accesses Federal dollars for catastrophic terrorism losses, TRIA has effectively established a solvency safety net. This safety net provides the certainty and stability necessary for individual insurers to understand and manage their potential exposure to losses attributable to terrorism attacks, while providing a cap on the potential loss to capital from such an attack. Put another way, far from “crowding out” private market capacity, TRIA’s structure creates the environment in which a private terrorism insurance market can exist and function.

In the event of a future terrorist attack, TRIA ensures that private insurance payments flow to those affected businesses that have purchased coverage, as well as to their employees, which in turn helps businesses and the economy recover. These payments will be crucial to minimizing the economic, psychological, and social fallout from an attack. The industry responded effectively to the tragic events in Boston and has the capacity to address single site conventional attacks in the future if they happen. At the same time, if an attack is so massive that it triggers the Federal protection established by TRIA, as noted, Government payments can ultimately be recaptured through a recoupment mechanism that was established in the legislation. This greatly mitigates any taxpayer costs of this Federal program.

It is important to emphasize that taxpayers are protected at every step under TRIA. First, they benefit from the economic security that insurance coverage provides before an attack. Second, after an attack occurs, the immediate flow of claims payments from insurers provides stability and minimizes economic disruption to those who suffer from the attack directly, as well as to all Americans. And finally, in the event of a catastrophic terrorist attack that triggers the Government program, any dispersed Federal funds can ultimately be repaid through TRIA’s recoupment mechanism. Thus, TRIA is both a sensible and indispensable component of national economic security.

The Unique Challenges of Insuring Terrorism Risk

A public-private solution is necessary for the risk of terrorism because it is fundamentally different from other exposures. Private insurance markets are founded on the ability to compile relevant data to (a) measure the likelihood and potential severity of loss to a policyholder for any specific peril and then (b) effectively pool the loss experience across many policyholders exposed to relatively homogeneous, random and independent risks. Quite the opposite, terrorism involves an intentional act carried out at the direction of individual actors and groups with the explicit intention of maximizing overall loss of life and property, as well as economic disruption across as many insureds as feasible. Quite simply, a terrorist attack is not a fortuitous event. Furthermore, terrorism exposure lacks a broad-based spread of risk. Terrorists can pick the target, change the target to bypass security and loss mitigation, and coordinate an attack on multiple targets in diverse locations. The adage—“where there’s a will, there’s a way”—is particularly appropriate for terrorism risk and effectively neutralizes private mitigation efforts.

Equally important, much of the information regarding terrorist plans and potential targets comes from national security data that is appropriately of limited availability to the public. Insurers therefore lack any sound informational basis for assessing the likelihood or probability of a major terrorist attack. While insurers can price insurance when the nature of the risk is estimable but highly uncertain, *ex ante* (before the event) insurance mechanisms fail when there is no credible basis for assessing the likelihood of an event.

The potential magnitude or severity of large scale terrorist attacks, particularly those that involve the use of unconventional weapons involving nuclear, biological, chemical, and radiological (NBCR) agents, is largely unknown given the fortunate dearth of prior experience. While insurers have managed loss aggregations for most “conventional” attack modes under TRIA, the industry has limited information on managing exposures to wide-area loss event scenarios that would be the hallmark of NBCR attacks.

The challenges associated with wide-area NBCR terrorism are also manifest in the newest form of unconventional terrorist threat—cyber-terrorism. Under a cyber attack, the origin of the attack can be from any single location where there is a computer and access to the Internet. However, the ultimate victims of the attack can be numbered in the thousands or millions, can be widespread geographically, and can be located in any area of the United States. In this setting, traditional insurance company means of exposure management are challenged.

Given the concentration of insured lives and property values in business centers and the unique nature of cyber-terrorism, the risk of wide-area terrorism attacks poses a real solvency threat to insurers—a threat that can easily eclipse that of natural disasters given the stated intention of a terrorist to maximize economic damage and disruption.

Limited Risk Management Tools are Available

Even with the existence of TRIA, insurers' ability to manage terrorism risk is limited. From a coverage perspective, while TRIA requires a mandatory "offer" as a condition for participation, State laws actually mandate coverage for terrorism for certain lines of insurance. For example, in the 49 States that require workers' compensation insurance, insurers may be obligated to cover on-the-job injuries without exclusion, whatever the cause. Further, a number of States (including those with significant business centers) mandate that insurers cover terrorism-created fire losses, even if a policyholder does not purchase terrorism coverage. As a result, while an insurer may exclude NBCR terrorism coverage in some States, losses caused by the fire following an explosion from one of these perils may be covered.

In addition, as noted above, the industry's lack of credible methods for assessing the likelihood of an attack limits our ability to determine an actuarially fair premium. As noted by the most recent 2010 report on terrorism risk insurance market conditions from the President's Working Group on Financial Markets (PWG Report), "despite the reported improvements in modeling to measure an insurer's aggregate loss exposure, the industry remains uncertain about the reliability of probabilistic models to predict frequency and severity of terrorist attacks."[2]

Further, reinsurance capacity for terrorism losses is minimal. Unlike primary commercial lines insurers, reinsurers are not subject to the "make available" clause in TRIA, and their appetite for this risk reflects what type of private market might exist absent TRIA. Citing many of the same issues identified above for primary insurance companies, reinsurance companies offer extremely limited capacity for terrorism risk and generally do not offer coverage for terrorist attacks committed with NBCR weapons. According to the 2010 PWG report, reinsurance capacity available for terrorism risk remains in the $6 billion to $10 billion range,[3] an amount that is well below the estimated industry-wide retention figure under TRIA and well below the mandatory recoupment amount of $27.5 billion in insured terrorism losses.

To provide some perspective, The Hartford's 2014 retention under the Terrorism Risk Insurance Program Reauthorization Act (TRIPRA) is approximately $1.2 billion in company losses. With respect to property, terrorism reinsurance of any material amount within this retention is effectively nonexistent. In contrast, for natural catastrophe losses, The Hartford's principal corporate catastrophe treaty provides just under $800 million in reinsurance protection in excess of a $350 million deductible. The Hartford has an additional $135 million in hurricane reinsurance protection financed through nontraditional reinsurance markets (*e.g.,* catastrophe bonds). I wish that the reinsurance markets were willing to provide the same capacity for terrorism within our TRIA retention as is available for natural catastrophes. But, as a company that recently conducted a comprehensive request for proposal process, I can tell you that the reinsurance capacity is simply not available. The 2010 PWG report is interesting in that it indicates that the total amount of reinsurance capacity is up slightly from prior studies. The small increase in reinsurance capacity, undoubtedly available to smaller companies, actually demonstrates the value of the TRIA program to "crowd in" additional reinsurance capacity—that is, it provides reinsurers some assurance that the reinsured companies can manage through a large scale event and remain viable trading partners after a loss.

Given these challenges, how do insurance companies manage the risk of terrorism today? The main tool available to manage the risk of terrorism is to limit exposure concentrations in potential "high target areas." If terrorism exposure concentrations get too high relative to surplus, an insurance company could nonrenew entire com-

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[2] Report of the President's Working Group on Financial Markets, "Market Conditions for Terrorism Risk Insurance 2010," at p. 18.

[3] *Id.* at 19.

mercial policies to reduce the terrorism exposure—often creating hardships for the underlying policyholders. These exposure concentrations are especially difficult for certain lines of business like workers' compensation and property insurance, including "fire following" coverage in certain States where exclusions for NBCR attacks are not recognized. Over the past 11 years, with the benefit of TRIA, the insurance industry has successfully managed these concentrations of exposure within the TRIA retentions. Policies shed by one company have generally been absorbed by a competitor.

Without TRIA, however, individual insurers would face large uncapped exposure and would face difficult choices about how to manage down exposures relative to capital, including facing decisions on whether or not to nonrenew large portions of their commercial policyholder portfolios, especially given the fact that they cannot exclude the peril of terrorism from workers' compensation coverage and property insurance including the "fire following" coverage in a number of States. In fact, a recent report from Marsh outlined steps that insurers are taking to limit their workers' compensation insurance exposure in light of the continued uncertainty of the future of TRIA. Marsh notes, "Because insurers cannot exclude terrorism related losses and employers are required to buy it, the options available to buyers have been reduced and rate increases have accelerated."[4] For the record, we do not believe that this outcome would be in the best interests of our policyholders or the overall economy.

Proposals to Modify TRIA and Alternative Private Market Solutions

As this Committee knows, the expiration of TRIA at the end of this year presents an opportunity to reexamine the program's merits and the feasibility of modifications designed to improve its efficacy. Almost a dozen years into TRIA, there should be no doubt that the program has brought stability to the private market and has enabled insurers to provide capacity despite the unique characteristics of this risk. TRIA has been shown thus far to be a successful partnership among the Federal Government, insurers, and policyholders to protect the economy in the event of an attack. Thanks to TRIA and its successors, The Hartford has been able to manage our terrorism exposure within acceptable limits while supporting our policyholders' need for terrorism coverage.

Nonetheless, there continue to be calls to modify the level of Federal participation as a means of increasing terrorism insurance capacity. Indeed, some have questioned the need for a continued Federal role in backstopping the terrorism insurance market—preferring to prod the markets to develop a purely private solution. The premise of this line of argument is that a market solution, even if second best, is still more desirable than a solution that involves Federal Government participation. As a general approach on many public policy issues, we support this view. Unfortunately, as we have stressed, terrorism risk is the exception to the market-oriented approach. The existence of the public-private shared loss program enables the market to function.

Eliminating TRIA, or altering it in ways that make the Federal role meaningless, will not lead to an expansive private market. Instead, it would very likely lead to a model for terrorism where many businesses retain the risk of terrorism and the Federal Government loses the robust and stable private terrorism insurance market that TRIA has enabled. While it may be true that the first two extensions of TRIA increased insurer retentions and the industry adapted, any further increases incorrectly aimed at growing private market capacity for this risk may take us over the precipice, and result in a decrease in insurers' ability to offer terrorism coverage.

As we have outlined, the industry's ability to take on more terrorism risk is constrained by our limited ability to manage terrorism risk, the availability reinsurance, regulatory rate and policy form restrictions, and the need to protect company solvency. From The Hartford's perspective—one that is shared by AIA—manipulating TRIA's levers will not increase the supply of reinsurance nor will it allow us to exceed our risk concentration limits and rather may only serve to put more of our capital and, therefore, our solvency at risk. Indeed, at least one rating agency has stipulated that companies could experience ratings pressure if their net exposure to terrorism exceeds 20 percent of capital and surplus. Total surplus, of course, covers all extraordinary events that may be covered under our policies, from hurricanes, earthquakes, and storms to fires and other accidents that are in excess of reserves. It is not just used to cover terrorism loss.

Note that today, for most large commercial insurance companies, retentions under TRIA already average 8 percent to 12 percent of total surplus. Approaching that 20

[4] Market Risk Management Research Briefing, "Pending TRIPRA Expiration Impacts Workers' Compensation Industry", at p. 1 (Jan. 2014).

percent surplus number identified by the rating agencies may be the tipping point that causes insurers to curtail our aggregate exposure to risks of all types, not just terrorism, which could cause a severe and immediate disruption to the economy, reduce the supply of affordable terrorism coverage, and potentially diminish the Nation's prospects for an orderly economic recovery in the wake of a catastrophic terrorism event. If we reach that tipping point caused by well-intentioned, but misguided efforts to further increase private market capacity for this risk, the net result could be that terrorism risk could be redistributed to business owners, borrowers, lenders, employees, and—very likely—the Federal Government itself through post-disaster relief aid.

Conclusion

Since its enactment in 2002, TRIA has been a success. Terrorism insurance is available and affordable throughout the United States, eliminating economic uncertainty and keeping our economy moving as the long recovery finally gathers momentum. TRIA works because it is an effective partnership between the private sector and the Federal Government—maximizing private market risk bearing and infrastructure while leveraging the Government's pooling capabilities for noninsurable risks that align with our national defense policy. Moreover, TRIA has been administered at minimal cost to taxpayers. TRIA is serving as a key element in maintaining an orderly economic recovery should there be another catastrophic terrorist attack on U.S. soil—prepositioning resources to respond to an attack and thereby thwarting a principal objective of terrorism. At the same time, both AIA and The Hartford recognize that any legislation presents opportunities for improvement, especially against a backdrop of continuous change, and we stand ready to work with the Congress and the Administration to evaluate any potential changes to the legislation and their potential impact on the effective balance achieved by TRIA.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR COBURN FROM CAROLYN SNOW

Q.1.a. The original authorization stated that TRIA would "provide temporary financial compensation to insured parties, contributing to the stabilization of the United States economy in a time of national crisis, while the financial services industry develops the systems, mechanisms, products, and programs necessary to create a viable financial services market for private terrorism risk insurance."

What steps, if any, has the private sector taken to create a viable private terrorism risk insurance market?

A.1.a. Private insurance carriers are constantly looking for new and innovative products to offer their customers in order to get an edge on their competitors. We believe that if there were a private market solution, then it would have been found; unfortunately, terrorism risk continues to have the following characteristics that make it nearly impossible to underwrite: terrorism risks are not accidental, but are the result of human behavior; terrorism risk thankfully lacks the historical data and experiences that make modeling possible for other risks; and predicting the severity of losses is difficult as the potential range of losses varies wildly.

It also remains true that terrorist attacks often have underlying political motives that are the result of governmental policies, and that successfully carried out attack is the result of a homeland security or intelligence failure. Therefore, we feel that the Government will always have some responsibility in the recovery from such an event.

Q.1.b. What incentives does the property/casualty insurance industry have under TRIA to try to create a private terrorism risk insurance market?

A.1.b. As stated in our previous answer, we believe that private carriers are always looking for new products that would give them a competitive advantage over their competitors. We believe that if it were possible to provide a fully private market solution, then the industry would have found it by this point. It's also important to note that the private industry has a significant stake in the terrorism insurance market as TRIA currently stands. The industry is responsible for the first $100 million and share of all losses once the TRIA trigger is reached. They are then responsible for reimbursing the Government, with interest, following a major terrorist attack.

Q.1.c. Do you believe that private reinsurance companies can fairly compete against the Federal TRIA program?

A.1.c. The private markets are not competing with the Federal Government because there is no adequate market for terrorism insurance. While there have been signals that the reinsurance market has excess capital ready to be used, there is no guarantee that this capital would be used for terrorism risk should TRIA be allowed to expire. Even if this capital were initially used in the terrorism market, it is likely that it would quickly dry up following a major terrorist attack and we would find ourselves back in the same situation we found ourselves in immediately following 9/11.

Q.2. Do you believe TRIA should be a permanent public-private risk-sharing mechanism?

A.2. We do believe that TRIA should be a permanent public-private risk-sharing mechanism. Terrorism risks continue to be extremely difficult, if not impossible, to model for, and we do not expect that to change in the future. TRIA has proven to be effective at ensuring adequate capital is in the marketplace at rates affordable to commercial insurance consumers. We believe that a program should always be in place that will provide and efficient and orderly response to any future attack, and the TRIA program does just that, all while costing the Government nothing. Such a program is essential to the economic health of the United States.

Q.3. Beyond the triggering threshold and deductible, TRIA provides for a taxpayer provided backstop for terrorism coverage. What is the value of this backstop for insurance companies (if a nominal figure cannot be determined, please indicate if it more than zero)?

A.3. As the organization representing commercial consumers, it is difficult for us to comment on the exact value of the TRIA backstop to insurance companies; however, the backstop has certainly allowed companies to free up capital to be used for terrorism insurance. As we saw immediately following 9/11, this capital would be unavailable at affordable rates without the TRIA backstop in place. We also want to reiterate that the TRIA program has cost the Government nothing to this point, and if the program is triggered, the Government is able to recoup its losses from the private industry.

The benefit to our members, commercial insurance consumers, is in the adequate availability of terrorism coverage that our members can afford. A 2013 survey of our membership found that 69 percent of respondents believe their terrorism coverage limits would decrease, or that coverage would not be offered at all, should TRIA be allowed to expire.

Q.4. Should the American taxpayers be compensated for the risk through TRIA with front-end premiums?

A.4. Companies are required to reserve terrorism premiums in the same manner as they do other insurance premiums however the way the program is currently designed the American taxpayers have not incurred any costs. To require the companies to pay a portion of these reserves to the Government would, in our opinion, have a further negative impact on the market and create yet another Government fund to be managed.

TRIA is unique from other Government insurance programs, such as the National Flood Insurance Protection (check me on correct name) in that there is a requirement for repayment from the insurance companies. Other programs do not require repayment and in event of terrorist act without the TRIA backstop the American taxpayers would foot the costs.

Q.5. TRIA is intended to protect the insurance industry from insolvency in the case of catastrophic losses due to a terrorism event. Currently, TRIA is triggered after $100 million in aggregate industry losses in a single year.

Would you consider $100 million in industry-wide losses a catastrophic loss that threatens the solvency of the insurance industry? If not, what would that amount be?

A.5. While the industry as a whole may be able to absorb a $100 million loss, individual companies may not be able to absorb their respective losses depending on the size of the company and the concentration of risks in the area affected by the terrorist event. A small- or medium-size company would be able to absorb far fewer losses and a catastrophic $100 million plus event may very well render those companies insolvent, or very close to it. It's also important to note that the industry's losses are not capped at $100 million. They are still responsible for a 20 percent deductible above that amount and then 15 percent of all losses even above that. The loss from a terrorist event could be much higher than $100 million.

Q.6. The reinsurance industry has roughly $510 billion in total capital available and the amount is projected to increase.

How much additional capacity does the private reinsurance industry have to take terrorism risk away from the taxpayers? What is the average pricing for private reinsurance coverage?

A.6. The 2010 President's Working Group on TRIA found that the reinsurance market had only $6 to $10 billion available for terrorism risk. This is well below the required industry retention under TRIA and significantly below the mandatory recoupment amount of $27.5 billion. While the reinsurance industry has more capital available generally, we have serious doubts that this capital will be used toward terrorism risk should TRIA expire. We saw reinsurance capacity dry up immediately following 9/11 and would have serious concerns that a similar situation would occur in the event of another large-scale attack. The reinsurance sector also continues to face the same limits on modeling and managing terrorism risks that the rest of the industry faces.

Q.7. What are the aggregate annual premiums collected by the insurance industry each year for terrorism risk coverage?

A.7. While we do not have data on the aggregate premiums, a 2013 report by Marsh, a large insurance broker, found that 2012 premiums rates ranged from a median rate of $48 per million of total insured value (TIV), for companies with TIV less than $100 million, to a median rate of $19 per million of TIV for larger companies. Rates ranged from 3 percent to 5 percent of overall property premiums depending on factors such as company size, location, and industry sector.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR COBURN FROM BILL HENRY

Q.1.a. The original authorization stated that TRIA would "provide temporary financial compensation to insured parties, contributing to the stabilization of the United States economy in a time of national crisis, while the financial services industry develops the systems, mechanisms, products, and programs necessary to create a viable financial services market for private terrorism risk insurance."

What steps, if any, has the private sector taken to create a viable private terrorism risk insurance market?

A.1.a. There is no viable private terrorism risk insurance market without TRIA. Terrorism risk is uninsurable because it is only questionably quantifiable, totally unpredictable, and, therefore, essentially impossible to underwrite. To the extent a private market exists today, it is because the private market is writing coverage within the predictable parameters set by TRIA. Without the Federal backstop, the private coverage available—if there was any—would be extremely limited and prohibitively expensive.

We know this because that is what happened in the period after 9/11 before TRIA was enacted, and during the months of uncertainty before TRIA was reenacted in 2005 and 2007. For example, even in Dallas, and elsewhere in Texas, we had difficulty after 9/11 getting insurance companies to insure workers compensation (for which terrorism exclusions are not allowed) for employers with over 50 employees. This pressure eased with enactment of TRIA. Indeed, since the enactment of TRIA, we have seen prices for terrorism risk coverage decline, and take-up rates increase across the country and across industries. For companies with a higher perceived risk, whether due to size, location, industry or other factors, the take up rates exceed the average. This shows that there is demand for coverage—and if the insurance industry was able to underwrite it, they would do so.

Q.1.b. What incentives does the property/casualty insurance industry have under TRIA to try to create a private terrorism risk insurance market?

A.1.b. The insurance industry has the same incentives to try to create a private terrorism risk insurance market as it does to create a market for any other type of risk: that is, if there is an insurable risk for which a viable insurance program can be created, the insurance industry can make money by underwriting those risks. The only difference under TRIA is that terrorism risk is not predictable or quantifiable, so it is not insurable like other risks are. The Federal backstop, therefore, is necessary for insurers to define the limits of their exposure so that they can price the coverage correctly so that, if a covered event occurs, they have the reserves to pay the claims.

This is a critical point: insurers cannot cover unlimited or undefined risks because they cannot price for it. If they underprice coverage and a terrorism event occurs, insurers will not have the reserves to pay the claims. If they charge too much for coverage, consumers will not be able to afford coverage and won't buy it—leaving them exposed to terrorism risk and reliant on the Government for assistance if a terrorist attack occurs.

The issue before Congress, then, is not whether a private terrorism risk market will develop—it won't in any meaningful way. Rather, the issue is whether the Government will work with the insurance industry to thoughtfully and deliberately develop a plan *before* a terrorist attack to maximize private sector participation in addressing the massive damages that will result from a terror strike, as opposed to Government reacting alone in crisis mode after an attack occurs.

We know the Federal Government will step in to provide assistance after a terrorist attack, particularly if there is insufficient private sector relief available. It is our obligation to our fellow citizens when tragedy strikes. We do not shirk from that duty, and we are all on the hook as taxpayers when the Government steps in to help. In the absence of a viable, stand-alone private market, the public-private partnership represented by TRIA has incredible value. TRIA brings the private insurance market into the equation with the financial support and organizational expertise the industry has to offer: direct contribution through upfront premium payments, relief delivery through established claims processes, and a repayment mechanism through policyholder surcharges after the event. Thus, it is not a question of whether the Federal Government will pay, but rather whether the Federal Government will work with the insurance industry to ensure that the preparation and response to a terrorist attack is handled in the most efficient and cost-effective way possible. Better TRIA than FEMA.

Q.1.c. Do you believe that private reinsurance companies can fairly compete against the Federal TRIA program?

A.1.c. I do not believe that reinsurers have the capacity to provide the coverage needed to reinsure all the potential terrorism risk out there. So I do not believe it is a matter of competition, fair or otherwise. To me, it is simply a realistic view of the risk and the capacity and ability of the private sector—insurers and reinsurers—to cover that risk. It has been my experience that the private sector cannot cover terrorism risk without TRIA, and that, with TRIA, the marketplace works, both at the insurance and reinsurance levels.

Q.2. Do you believe TRIA should be a permanent public-private risk-sharing mechanism?

A.2. Yes, TRIA should be made a permanent public-private risk-sharing sharing mechanism. Terrorism is not an insurable risk. If it were—if private insurers and reinsurers were willing and able to cover all terrorism risks—then a private market would have developed. Such a market has not and will not develop without the Federal backstop.

Q.3. Beyond the triggering threshold and deductible, TRIA provides for a taxpayer provided backstop for terrorism coverage. What is the value of this backstop for insurance companies (if a nominal figure cannot be determined, please indicate if it more than zero)?

A.3. The value of the backstop is not for insurance companies that write TRIA coverage, but for the economy as a whole. Without the TRIA backstop, terrorism coverage would dry up because insurers would not be willing to expose themselves to potentially unlimited terrorism risks, and there is not enough capacity in the private market (including reinsurance) to cover a risk that is unpredictable. So the existence of TRIA actually brings insurers into the terrorism risk coverage marketplace when they otherwise would have avoided the market altogether. This not only brings the insurance sector's underwriting capacity (limited though it is) to the terrorism risk space, it also brings in the organizational expertise the industry has to offer: direct contribution through upfront premium payments, relief delivery through established claims processes, and a repayment mechanism through policyholder surcharges after the event. Thus, it is not a question of whether the Federal Government will pay, but rather whether the Federal Government will workwith the insurance industry to ensure that the preparation and response to a terrorist attack is handled in the most efficient and cost-effective way possible.

Q.4. Should the American taxpayers be compensated for the risk through TRIA with front-end premiums?

A.4. Front-end premium payments do not make sense. The risk is to the economy and the American taxpayer, and they are the ultimate beneficiaries of TRIA. Without TRIA, terrorism coverage would dry up, and, with it, all the benefits the insurance sector brings. Imposing front-end premiums would only discourage insurers from participating in the marketplace. Moreover, there is a repayment mechanism in place under TRIA in the post-event assessments that are to be imposed under the program. This is akin to the way the State insurance guaranty programs currently operate. The insurance industry has operated under the State guaranty programs for years and it has proved to be a workable solution. We see no need to operate differently under TRIA.

Q.5. TRIA is intended to protect the insurance industry from insolvency in the case of catastrophic losses due to a terrorism event. Currently, TRIA is triggered after $100 million in aggregate industry losses in a single year.

Would you consider $100 million in industry-wide losses a catastrophic loss that threatens the solvency of the insurance industry? If not, what would that amount be?

A.5. I do not have an opinion as to the exact number for the trigger. The carriers would be in a better position than I to make such a recommendation. Having said that, I note that, depending on the concentration of the loss, a $100 million loss could threaten the solvency of many smaller insurers that provide terrorism risk coverage, and the goal should be to encourage as many insurers as possible to participate in the marketplace to provide as much private sector "skin in the game" as possible.

Q.6. You mentioned during the hearing that insurance is a competitive industry, and if there was a private market solution for terrorism risk coverage it would have presented itself already.

Do you believe a Federal taxpayer backstop for terrorism risk coverage with no upfront cost is competitive environment that can facilitate innovative privatemarket solutions?

A.6. Insurance is a competitive industry—but terrorism risk is not an insurable risk in the same way that other risks, like car crashes or house fires, are. Therefore, without TRIA to set the limits of insurers' exposure, there would be very little—if any—terrorism coverage available in the private market, and the coverage that was available would be prohibitively expensive and effectively unavailable to most, if not all, consumers.

Although the specific numbers could be tweaked—the trigger, the retention amount, *etc.*—the basic structure of TRIA has worked: a strong private market has developed to cover the risks that would otherwise be uninsurable. And there is plenty of room—and potential incentive—within the parameters of the program for insurers to provide coverage and develop innovative private market solutions if any such solutions exist.

RESPONSE TO WRITTEN QUESTION OF SENATOR KIRK FROM VINCENT T. DONNELLY

Q.1. Mr. Donnelly, you also discussed the rating agencies in your writing statement—anything to add?

A.1. Financial ratings are critical to the viability of commercial insurers, and are a key tool used by commercial policyholders to assess the quality of the coverage they are buying. Thus, any deterioration in an insurer's financial ratings can have very negative consequences and, in some cases, could force some small- and medium-sized insurers out of the market and even larger insurers to withdraw capacity from key economic areas to protect their solvency.

I noted in my testimony that numerous insurers are in great danger of having their financial ratings downgraded if TRIA is not reauthorized or if it is reauthorized with large increases in the deductibles, co-shares, or the trigger. I called the Committee's attention to a recent report from A.M. Best suggesting that, even at the current 20 percent deductible, a number of small- to medium-sized companies may be subject to ratings downgrades.

Subsequent to the hearing, Standard & Poor's (S&P) published a report which reached a similar conclusion. S&P concluded that if some of the potential threshold changes to TRIA are made, "small insurers with less capital and more terrorism exposure could be subject to negative rating actions."

As I indicated in response to a question from Senator Coburn, small- and medium-sized insurers represent almost 98 percent of all insurers writing TRIA coverage and almost half of all TRIA-related premiums. They are a critical source of terrorism coverage as well as insurance meeting all of other needs of businesses large and small in the country. Their presence in the market keeps it healthy and competitive. If TRIA deductibles, co-shares, or the trigger are significantly increased, the predictions of both A.M. Best and S&P regarding ratings downgrades are very likely to come true for a significant number of insurers. The only way many of these companies could avoid such downgrades would be to exit TRIA-covered lines entirely. This would have a negative effect on availability of many lines of insurance, including terrorism, and would be anticompetitive.

Finally, while insurers have so far been able to absorb and manage the new demands that previous reauthorization bills have placed on them, the ratings agencies warnings this year are more pointed and alarming than ever before. There is an outer limit on how much terrorism risk commercial insurers can accept before they have to make tough decisions about exiting lines and markets to protect their solvency. The alarming predictions of both A.M. Best and S&P strongly suggest that the industry, and small- to mid-sized insurers in particular, are nearing the outer edge of their ability to absorb terrorism risk. While it is appropriate for Congress to consider ways to continue to protect taxpayers, the rating agencies' warnings suggest Congress must also take extreme care not to push the industry past its tipping point.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR COBURN FROM VINCENT T. DONNELLY

Q.1.a. The original authorization stated that TRIA would "provide temporary financial compensation to insured parties, contributing to the stabilization of the United States economy in a time of national crisis, while the financial services industry develops the systems, mechanisms, products, and programs necessary to create a viable financial services market for private terrorism risk insurance."

What steps, if any, has the private sector taken to create a viable private terrorism risk insurance market?

A.1.a. TRIA mandates that private insurers make terrorism coverage available to all businesses purchasing insurance on the same terms and conditions for those lines protected by TRIA's loss limits. Under TRIA, the private sector shoulders the risk for all but the most catastrophic events, including a $27.5 billion aggregated industry retention.

TRIA was enacted because private insurers were unable to model terrorism risks in the aftermath of 9–11. At the time, it was hoped that modeling would improve to the point where it would be possible for the private sector to take all terrorism risks, eliminating the need for a Federal program. While some progress has been made, that goal has simply not yet been achieved. It is possible to model the potential severity of a delineated attack. However, it is not possible to model the likelihood or frequency of future terrorist attacks or of coordinated attacks on multiple locations or the magnitude of a large scale terrorist attack involving nuclear, biological, chemical, and radiological (NBCR) weapons. There is insufficient historical loss data upon which to base such models and terrorism risk prevention and mitigation largely arises from Federal Government national security activities. Also, unlike hurricanes and most other catastrophic risks, terrorism is not random; in fact, terrorists can target their actions to maximize losses against certain victims and circumvent mitigation measures.

Not every risk is insurable in the private marketplace. TRIA continues to exist because there is a natural limit to how much terrorism risk the private market is willing and able to accept. Without TRIA's limits on terrorism loss exposure, terrorism risk would be very similar to war risk, which private insurance generally excludes (except where coverage is mandated under State law).

Other major countries which have a significant terrorism risk have developed some sort of Government program to deal with the problem. TRIA is better than most other programs because it is more fiscally responsible. But without TRIA, as seen in 2005 and 2007 as the program neared expiration, the private market excluded terrorism coverage altogether for a majority of commercial policies.

A.1.b. What incentives does the property/casualty insurance industry have under TRIA to try to create a private terrorism risk insurance market?

TRIA has already succeeded in creating a private terrorism insurance market where it had all but disappeared in the aftermath of 9–11. The private marketplace now has a $27.5 billion aggregated industry retention. The amount insurers have to absorb within their 20 percent TRIA deductible has already increased from $25.7 billion to $35.6 billion since the program was created—a nearly 40 percent increase. If TRIA is reauthorized with higher deductibles, then the retained risk for small- and mid-sized insurers as well as certain large insurers would exceed their maximum acceptable loss limits, effectively forcing them out of the market.

In addition to the deductible, each insurer must also pay 15 percent of all losses over the 20 percent TRIA deductible. This co-share imposes an additional catastrophic exposure on top of the 20 percent deductible. Increasing the 15 percent co-share could destabilize the terrorism insurance marketplace by increasing capital costs, which could cause a decrease in private sector capital allocations to terrorism coverage.

Significant changes to TRIA that detrimentally impact insurance companies could also result in rating agency consequences, because no insurer can risk a single event wiping out its capital base potentially creating market disruptions for policyholders. Thus, while an extensive private insurance market has now been created under TRIA, the risk exposures are far beyond what most of the private sector would offer without the program in place. These concerns are highlighted by the A.M. Best Briefing "As Expiration of TRIPRA Approaches, Rating Pressure Increases," April 1, 2013.

Q.1.c. Do you believe that private reinsurance companies can fairly compete against the Federal TRIA program?

The vast majority of private reinsurers say that they do not compete against the TRIA program. Although commercial reinsurers have opposed virtually every other proposal for Government-reinsurance programs (*e.g.,* natural catastrophe programs), they support TRIA. The Reinsurance Association of America (RAA) is on record in support of reauthorizing TRIA. A small number of reinsurers have suggested that they may be willing to take on a bit of the terrorism risk now covered by the program. But it is important to recognize that they are interested only in a relatively small layer of coverage—they do not propose to come anywhere close to filling the gap that would be created if TRIA were not reauthorized or even if the thresholds were increased substantially. In addition, much of the needed reinsurance capital may not be available in high risk aggregated regions or for nuclear, biological, chemical, radiological (NBCR) risks. And the willingness of reinsurers to assume an additional layer of risk today may reverse in the future if market conditions change, for example by the occurrence of a major catastrophe depleting global reinsurance capital or an improvement in alternative investment opportunities.

Q.2. Do you believe TRIA should be a permanent public-private risk-sharing mechanism?

A.2. When TRIA was first enacted, it was envisioned as a temporary program that would fill a gap until such time as the private industry developed the ability to model and price terrorism risk without the protection of a Federal program to limit private insurer liability. While there have been improvements in terrorism risk modeling since 9–11, it remains the case that modeling cannot accurately predict the frequency or likelihood of future terrorism attacks. Unlike natural disasters, for which there is substantial historical data, terrorist attacks have fortunately been relatively rare, resulting in a paucity of historical loss data to use in modeling. This is why every other country in the world that has established a terrorism program has made it permanent. While we can hope for a day when a Federal terrorism risk management program will not be necessary, that day has not arrived. The inescapable conclusion is that as long as terrorism attacks threaten our country, we must protect America's economic vitality both before and after a terrorist attack. TRIA has been very successful and continues to make terrorism coverage widely available. It is essential that the program be maintained to protect the U.S. economy.

Q.3. Beyond the triggering threshold and deductible, TRIA provides for a taxpayer provided backstop for terrorism coverage. What is the value of this backstop for insurance companies (if a nominal figure cannot be determined, please indicate if it more than zero)?

A.3. TRIA's primary value is not for insurers. It is for policyholders—the businesses that drive our Nation's economy. In the absence of TRIA and Government coverage mandates, insurers would be free to write only those terrorism risks they are comfortable writing and to avoid the rest. But TRIA requires insurers to make terrorism coverage available in order to ensure that the Nation's economic engine remains strong both before and after a terrorist attack. Coverage for injuries resulting from acts of terrorism including NBCR cannot be excluded under workers compensation policies in any State. In addition, a number of States mandate that insurers cover terrorism-created fire losses, even if a policyholder does not purchase terrorism coverage. Insurers support TRIA because it allows us to provide coverage to our policyholders and it serves a critical economic and national security function.

The question appears to be based on an assumption that insurers realize monetary benefit from TRIA. But in fact, TRIA has negative impact on most insurers, given that it requires insurers to accept risk they would otherwise choose not to accept and to retain much of the risk of loss on that business. In return for that, TRIA provides only partial loss limits above a significant insurer retention. Insurers do not profit from the backstop—they merely get partial reimbursement for losses arising from risks the Government required them to write and which they would in many cases have avoided otherwise. While many insurers do charge a premium for terrorism coverage, the difficulties in modeling make it impossible to know with any certainty whether the premium is adequate to cover even the insurer's share of potential losses. Such rates are also subject to review in many cases by State insurance regulators who often limit the rates insurers can charge. Insurance is a highly competitive industry with very low market concentration, giving companies little pricing power to charge in excess of a normal return on capital.

Q.4. Should the American taxpayers be compensated for the risk through TRIA with front-end premiums?

A.4. American taxpayers are greatly benefited by the economic benefits and resiliency that TRIA provides. They are further protected through TRIA by having the private insurance market bear the burden of all the most catastrophic terrorism risks, which insurers might otherwise exclude (as demonstrated by the widespread use of conditional terrorism exclusions on a majority of commercial policies issued in the TRIA transition years of 2005 and 2007 when extension of the program was uncertain). Having a mandate that private insurers offer terrorism coverage, and imposing a post-funded recoupment system commonly used in the States and for some Federal programs to fund any Government outlays through the marketplace protects the taxpayers. A pre-event charge or tax was considered in 2002 and each subsequent reauthorization, but was rejected by both Democratic and Republican majorities for a number of reasons:

- Pre-funding would be a tax on business and would hit urban areas the hardest since they are perceived to be at higher risk for terrorism.
- National security is primarily a Federal responsibility—businesses that would pay the tax are not able to mitigate their risk in the same way they could for weather or "more typical" workers compensation exposures.
- Pre-funding would not protect taxpayers with certainty since terrorism is inherently unpredictable:
  - If too little is collected, taxpayers may not be fully protected.
  - If too much is collected, the Government is taking money out of the economy for a risk that might not occur for 10, 20 or 100 years.
- Pre-funding ties up capital inefficiently, potentially for a very long time.
  - This depletes capital from the economy.
  - Post-funding is cheaper (no lost interest or lost opportunity costs) and still charged to those benefiting from the program.
  - If a pre-funded pool of money is collected in advance, there is a great danger that the money will not be preserved to protect taxpayers and be vulnerable to be used for other purposes.

Q.5. TRIA is intended to protect the insurance industry from insolvency in the case of catastrophic losses due to a terrorism event. Currently, TRIA is triggered after $100 million in aggregate industry losses in a single year.

Would you consider $100 million in industry-wide losses a catastrophic loss that threatens the solvency of the insurance industry? If not, what would that amount be?

A.5. A $100 million event would not threaten the solvency of the insurance industry on an aggregate basis, but then a terrorist attack would not hit the entire industry on an aggregate basis. Individual insurers would suffer individual losses, and small- to mid-sized insurers, in particular, could suffer life-threatening losses from a $100 million event that resulted in losses for the particular policyholders they insure. Small- and medium-sized insurers represent almost 98 percent of all insurers writing TRIA coverage and almost half of all TRIA-related premiums. They are a critical source of terrorism coverage as well as other lines of insurance meeting all of the needs of American businesses, large and small. Their presence in the market keeps it healthy and competitive. An excessive trigger would make it impossible for many such companies to continue to write terrorism and other business coverages, which would lead to less availability of coverage and less competition. That would be antithetical to TRIA's stated purposes. It was for that reason that the $100 million trigger was established. It is for that reason that it should be retained.

Attached is a brief paper provided by the Property Casualty Insurers Association providing greater detail on the role small- and medium-sized insurers play in the market and in the debate over TRIA reauthorization.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR KIRK FROM WARREN W. HECK

Q.1. The Federal Government is typically not very good at underwriting risk for insurance programs, such as the National Flood insurance program, which is currently $24 billion in debt. Can you explain how this insurance program is very different from other insurance programs? What, if anything, would need to be done differently to ensure TRIA does not end up being another unsustainable Federal insurance program?

A.1. By design, the Terrorism Risk Insurance Program is fundamentally different than any other Federal insurance program. The National Flood Insurance Program for example, is one that has the Government participating directly in insurance markets, underwriting the Nation's risk of flood losses. By contrast, TRIA stands behind the privately functioning market and only gets involved in the event of a catastrophic attack. In an event, the insurance company is responsible for losses up to a specified amount, based on its deductible and co-pay under the law. Hence, for smaller, more manageable events insurance companies pick up the full tab. Any additional losses are then initially paid by the Federal Government and then spread back throughout the private sector through the recoupment process. Any and all losses can be recovered under current law, the only question being what portion is *required* to be recovered and what portion is at the discretion of the Treasury Secretary. In this way, the TRIA program acts as a liquidity mechanism that transfers potentially ruinous losses not to the Federal Government, but *through* the Federal Government and back to the private sector.

The TRIA Program allows a robust private market to operate; and it does this at virtually no cost to the taxpayer in the absence of an attack. In fact, under TRIA insurance companies are required to make terrorism coverage available to all commercial insureds (although insureds may reject the coverage if they wish). Couple that with the fact that in an event, the Federal Government can recoup every penny of taxpayer money spent, and it is clear that the design of the TRIA Program prevents it from becoming another unsustainable insurance program.

Q.2. If the program is altered to nominally increase private sector participation by raising deductibles or the trigger level, but in reality caused some companies to flee markets and certain lines of business as we've been told would happen, wouldn't this reduce overall capacity instead of increasing it?

A.2. Yes, competition among insurance companies and overall capacity would likely be reduced. Under TRIA currently, an insurance company is already required to put over one-fifth of the value of their entire commercial book of business at risk for a single peril that could take the form of a single event. There is neither the appetite nor the ability for companies to jeopardize their ability to protect their policyholders by taking on more risk. Increases in the event trigger, company deductibles or insurer co-payments would almost certainly drive insurers—particularly medium and small insurers—out of the market, reducing competition and further constraining availability of terrorism risk coverage. Critics of the TRIA program mistakenly assume that any capacity lost due to the exit from the market of small- and mid-sized insurers would be replaced by large insurers that are able to attract and hold larger amounts of capital. This is not the case and a statutory increase in the insurer share of the losses could have the perverse effect of driving participants out of the market, resulting in a net outflow of capital that would otherwise be allocated to terrorism risk, thus actually increasing taxpayer exposure. Last, but equally important, is that increases to the trigger would have little to no effect on the fiscal purse over the long-term, but would create significant economic disruptions.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR COBURN FROM WARREN W. HECK

Q.1.a. The original authorization stated that TRIA would "provide temporary financial compensation to insured parties, contributing to the stabilization of the United States economy in a time of national crisis, while the financial services industry develops the systems, mechanisms, products, and programs necessary to create a viable financial services market for private terrorism risk insurance."

What steps, if any, has the private sector taken to create a viable private terrorism risk insurance market?

A.1.a. The private insurance market for terrorism risk is viable today for all but the most extreme and costly terrorist events. According to the Congressional Research Service, in 2011 the aggregate of all primary insurer deductibles under TRIA totaled approximately $34 billion, with private reinsurance capacity ranging between $6 billion and $8 billion. The willingness of private insurers to collectively allocate $34 billion of their own capital for terrorism losses can be attributed to the fact that the TRIA program allows each insurer to predict the amount of its maximum terrorism-related loss. Without TRIA, and given the potential magnitude of a major terrorism event, insurers' potential losses would be so great that few, if any, insurers would be willing and able to provide coverage.

The language you cite from the original TRIA authorization reflects the optimism of policymakers and some insurance analysts in 2002 that the terrorism threat could eventually be managed entirely by the private sector. Given what we have learned about the nature of terrorism risk since that time, it is clear today that TRIA or a similar program will probably always be needed to ensure that the private sector market for terrorism insurance remains as viable as it is today. The private insurance market is simply incapable of exclusively taking on the terrorism exposure because acts of terrorism are deliberate and not amenable to statistical predictability or valid underwriting evaluation.

Q.1.b. What incentives does the property/casualty insurance industry have under TRIA to try to create a private terrorism risk insurance market?

A.1.b. The industry's primary incentive is underwriting profit. Insurers earn underwriting profit by increasing the amount of premium they collect relative to the amount they pay in claims. If the industry believed that it could generate more profit by increasing its exposure to terrorism risk, it would do so, and it would not be asking Congress to reauthorize the TRIA program.

Q.1.c. Do you believe that private reinsurance companies can fairly compete against the Federal TRIA program?

A.1.c. Private reinsurance companies are able to supply only enough capacity to provide coverage for the exposure that primary insurance have through their company deductibles and co-payments under TRIA. The additional layer of coverage provided by TRIA is not available in the private reinsurance market. Because private reinsurers and the TRIA program provide separate layers of coverage, they do not compete with each other.

Q.2. Do you believe TRIA should be a permanent public-private risk-sharing mechanism?

A.2. Yes. See answer to 1.a.

Q.3. Beyond the triggering threshold and deductible, TRIA provides for a taxpayer provided backstop for terrorism coverage. What is the value of this backstop for insurance companies (if a nominal figure cannot be determined, please indicate if it more than zero)?

A.3. Because the Federal Government has the authority to recoup from insurers and their policyholders any funds disbursed from the TRIA "backstop," the nominal value of the backstop to insurers is zero.

Q.4. Should the American taxpayers be compensated for the risk through TRIA with front-end premiums?

A.4. Not if the goal is to ensure that taxpayers will be fully compensated for whatever losses the Government incurs under TRIA. The back-end recoupment mechanism allows the Government to compensate taxpayers for the entire amount of claims paid through the TRIA backstop. An upfront premium, on the other hand, would compensate taxpayers only for the risk of loss due to terrorism. Depending on the timing of a major terrorist event in relation to the period during which premiums were collected, it is possible that the Government's losses would greatly exceed the amount of premium the Government received, perhaps by several billion dollars. The payment of front-end premiums would have the effect of placing the Federal Government into the private insurance market in much the same way as NFIP has done.

Q.5. TRIA is intended to protect the insurance industry from insolvency in the case of catastrophic losses due to a terrorism event. Currently, TRIA is triggered after $100 million in aggregate industry losses in a single year.

Would you consider $100 million in industry-wide losses a catastrophic loss that threatens the solvency of the insurance industry? If not, what would that amount be?

A.5. A $100 million loss would not threaten the solvency of the entire insurance industry, but that is irrelevant because the losses that result from a terrorist event would not be spread "industry wide." Instead, the losses are likely to be concentrated among a few companies, or perhaps even a single company, whose commercial policyholder had the misfortune of being selected for a catastrophic terrorist attack. Raising the $100 million trigger to some higher level would mean that each company would have to be able to absorb losses equal to the amount of the new trigger amount.

For example, if the trigger was raised to, say, $500 million, each insurer would have to be prepared to pay for losses amounting to $500 million plus the sum of its 20 percent deductible and its 15 percent co-payment for any losses above $500 million. This would greatly increase the exposure of small- and medium-size insurers, many of whom would respond by declining to offer terrorism coverage, which in turn would have the effect of reducing the aggregate amount of private sector capital allocated to terrorism risk.

For example, if the trigger was raised to $500 million and buildings my company insured had the misfortune of being a target, a loss up to $499 would be borne completely by my company without TRIA. If we were unable to purchase stand-alone reinsurance, this would render my company insolvent. Even in a less extreme example of an industry loss of $450 million with a loss to my company of $150 million would be devastating and would weaken the company by significantly reducing its $405 million of surplus.

In the case of a target insurance company that had $1 billion in surplus, a loss of $499 million would wipe out half of its surplus and would be a devastating loss to the company, likely impacting its financial rating and ability to protect its other policyholders. I would add that of the approximate 2,600 p/c insurance companies operating in the United States only about 118 of them have $1 billion or more of surplus. Increasing the trigger beyond $100 million would greatly increase the exposure of the majority of small- and medium-size insurers, many of whom would be forced to respond by declining to offer terrorism coverage, which in turn would have the effect of reducing the aggregate amount of private sector capital allocated to terrorism risk.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR KIRK FROM DOUGLAS G. ELLIOT

Q.1. For any event to be deemed a "terrorist" event, the Secretary of Treasury, Secretary of State and the Attorney General must certify the event as an "act of terrorism" under TRIA (as amended). While TRIA (as amended), states that "[t]he Secretary shall provide an initial notice to Congress not later than 15 days after the date of an act of terrorism, stating whether the Secretary estimates that in aggregate insured losses will exceed $100 million". That being said, there is no specific deadline for the Government to certify an event as an "act of terror" which can often prolong and often complicate matters for insurers paying claims. Can you explain some of the issues that can arise when insurers are trying to pay on policies when there is question as to if the event is counted as an "act of terror"?

A.1. Many insurance policies track the TRIA definition of "a certified act of terrorism." Without timely certification by the Treasury Department, there can be uncertainty regarding coverage or lack of coverage both under the policy and under TRIA. This uncertainty can lead to a delay in the resolution of claims for policyholders and insurers, who are obligated under State law to make timely decisions on claims. To that end, the American Insurance Association (AIA), recommends dropping the $5m trigger that is currently necessary for Treasury Department certification, and establishing a statutory timeline for the certification process that requires a preliminary certification determination within 15 days of an event (or within 15 days of a petition for preliminary certification submitted by an insurer) and a final determination within 60 days, which can be extended by the Secretary of Treasury (with notice) if the investigation into the act remains outstanding.

Q.2. In addition to the certification timeline, we also want to look to see if the recoupment period in the current TRIA statute could be strengthened—either by making it mandatory and giving a specific timeline for repayment. Should there be some flexibility on this timeline—perhaps allowing the Secretary of Treasury to adhere to a recoupment timeline unless he can provide an explanation to Congress in writing rationale why recoupment for a specific TRIA event needs to be extended beyond the timeline, possibly providing a proposed timeline for recoupment?

A.2. Under TRIA, the Treasury is required to collect surcharges needed to recover 133 percent of the mandatory recoupment amount, being the Government's share of the first $27.5B of insured losses (the marketplace aggregate retention). If this amount is not sufficient to fully cover the Government's share, Treasury has discretionary authority to impose further surcharges on policyholders. Congress wisely decided to postpone the decision whether to impose higher surcharges on policyholders to a time when the Treasury and Congress can prudently assess the impact of such action on a wounded economy in the immediate wake of a potentially catastrophic event. Increasing the marketplace aggregate retention (*i.e.,* the mandatory recoupment amount) by a modest amount, however, may be a reasonable step.

As to the recoupment period, currently TRIA provides that if an act of terrorism occurs between January 1, 2012, and December 31 2014, the Secretary is required to collect surcharges needed to recover the recoupment amount by September 30, 2017. The recoupment period is supposed to start on January 1 following the act of terrorism. Therefore, for an act occurring in 2012 the recoupment period would be 4 years and 9 months, as compared to an act occurring in 2014, which would be 2 years and 9 months. A better rule would simply require recoupment within X years following the act of terrorism. Given the 3 percent cap on the surcharge, a 4-year period makes sense to allow for full collection of the recoupment amount. We agree that the Secretary should be able to extend this time period with the consent of Congress.

Q.3. There was a recent study in which A.M. Best said 19 percent of insurance units with terrorism risk exposure failed a stress test simulating a conventional weapons attack of a 5–6 ton truck bomb. Mr. Elliot, can you talk about the rating agency thresholds as a constraining factor for insurers?

A.3. The rating agencies have started to increase their focus on insurance company terrorism risk management and an individual company's terrorism exposure relative to surplus. As an example, at least one rating agency (A.M. Best) has been evaluating company exposure excluding the benefit of TRIA and has stipulated that companies could experience ratings pressure if (a) the net exposure to terrorism exceeds 20 percent of capital and surplus, or (b) aggregate exposures of risks in specific geographic areas are notably high, or (c) specific location concentrations can adversely impact capital. From a business and risk management perspective, where TRIA's levers are altered to increase the share of insured losses borne by insurance companies—whether that occurs by increasing insurer deductibles or co-shares—insurers will need to manage that increased financial exposure in a way that does not put financial solvency at risk. That may result in individual insurer decisions to reduce capacity or make other difficult business decisions to maintain the company or enterprise in sound financial condition.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR COBURN FROM DOUGLAS G. ELLIOT

Q.1.a. The original authorization stated that TRIA would "provide temporary financial compensation to insured parties, contributing to the stabilization of the United States economy in a time of national crisis, while the financial services industry develops the systems, mechanisms, products, and programs necessary to create a viable financial services market for private terrorism risk insurance."

What steps, if any, has the private sector taken to create a viable private terrorism risk insurance market?

Q.1.b. What incentives does the property/casualty insurance industry have under TRIA to try to create a private terrorism risk insurance market?

A.1.a.–b. Combining responses to questions (a) and (b), the Government's high-level participation in TRIA actually provides incentive for insurers to provide terrorism risk insurance coverage and allows a private market to exist by providing the certainty that the Government will backstop catastrophic insured losses from terrorism. Without TRIA, individual insurers would face difficult choices about how to manage their exposures and would have to ration their capacity in order to maintain their respective companies in sound financial condition. The assumption that a viable market would develop for terrorism risk was based on an unrealistic view that terrorism was like other insurable perils, such as wind and flood. Terrorism is not a similar insurable peril for many reasons:

It is difficult to underwrite the risk. Since acts of terrorism are intentional and the timing, nature, and mode of attack are solely in the hands of the terrorist, insurers cannot assess the frequency of an attack and have very little experience to draw upon. This is especially true for wide-area catastrophic attacks such as nuclear, biological, chemical, and radiological attacks.

Insurers are unable to spread risk effectively through reinsurance. A 2013 Marsh reinsurance study shows that capacity for terrorism losses is minimal (only $6–10 billion of reinsurance for terrorism losses is available across the industry and virtually no reinsurance capacity for nuclear, biological, chemical, and radiological or "NBCR" losses) because reinsurance companies are no more able to underwrite the risk than primary carriers.

Furthermore, the market for terrorism coverage is not a "true" free market in which institutions can choose to sit on the sidelines. State laws mandate coverage for terrorism for certain lines of insurance (workers' compensation and standard "fire following" policies). Because the insurer does not have any policy tools to help manage terrorism exposure, they must determine how to allocate their capacity. In some situations, an insurer's decisions on the level of acceptable terrorism exposure affect decisions to renew policyholders. Far from "crowding out" private market capacity, TRIA's public-private partnership has provided stability and certainty, and allowed commercial insurers to become more comfortable with individually managing terrorism exposures without compromising financial solvency.

Q.1.c. Do you believe that private reinsurance companies can fairly compete against the Federal TRIA program?

A.1.c. I don't believe reinsurance companies are truly competing against the Government. In fact, The Hartford does buy private reinsurance, and we'd like to purchase more. But, unfortunately, the traditional reinsurance markets are unable to meet our needs, particularly for wide-area events like a nuclear, biological, chemical, or radiological attack. Similarly, the capital markets have not demonstrated that they are able or willing to take on terrorism risk in a meaningful way. Today, there is nothing inhibiting the ability of the reinsurance or capital markets from providing coverage to The Hartford within the TRIA retention other than the uninsurable nature of the risk.

In terms of the reinsurance market for terrorism risk, the same insurability challenges that limit a primary insurance company's ability to underwrite terrorism risk constrain the amount of risk that reinsurers are willing to underwrite. And reinsurers are not compelled by Federal legislation or regulation to underwrite terrorism risk in the United States, nor are they constrained by State rate and policy form regulation. The result: reinsurance capacity for the risk of terrorism is extremely limited at $6–10 billion. Moreover, the terrorism reinsurance capacity that is available generally excludes losses caused by NBCR weapons and typically includes additional limitations in major metropolitan areas.

To put the $6–10 billion of reinsurance capacity in context, we estimate that the total amount of reinsurance capacity available for natural catastrophe risks in the United States is in the range of $90–120 billion. Given that the aggregate level of individual insurance company retentions is estimated to exceed $34 billion, today's terrorism reinsurance capacity is insufficient to satisfy even a portion of individual company reinsurance demand within existing TRIA retentions. As noted in recent testimony, the reinsurance that is available for terrorism is for conventional terrorism only.

At the same time, the fact that reinsurance capacity, however small, has grown from $4–6 billion to $6–10 billion since 2007 is encouraging for the market on two fronts. First, the increase in reinsurance capacity demonstrates that TRIA is not crowding out private reinsurance markets, but may in fact provide the stability for the marketplace that allows the program to "crowd-in" reinsurance capacity. Second, while the capacity does not offer an alternative to TRIA, the growth in reinsurance would be beneficial in improving the risk pooling opportunities for conventional terrorism risks within existing TRIA retentions.

Q.2. Do you believe TRIA should be a permanent public-private risk-sharing mechanism?

A.2. Unfortunately, insurers are no better able to quantify the likelihood of a terrorist attack than they were 12 years ago and the capacity of the reinsurance or capital markets to finance the peril of terrorism remains *de minimus*—and virtually non-existent for NBCR acts of terror.

As discussed in the prior answer, terrorism is not an insurable peril by its very nature. Terrorism involves intentional acts carried out at the direction of individual actors, with the explicit intention of maximizing loss. While there have been improvements in modeling, there is no reliable way to predict the adaptive nature of a terrorist.

Given the nature of terrorism risk and what we know (or don't know) about it, there may never be enough capacity in the private market alone and there will always be a unique need for Government participation. After all, it is the fact that the Government will share in terrorism losses at a catastrophic level that has allowed the private terrorism risk insurance market to function. In order to understand the potential for increasing private market capacity, one need look no further than the gap between aggregate insurer retentions under TRIA—at more than $30 billion—and the estimated $6—10 billion of available private terrorism reinsurance.

Q.3. Beyond the triggering threshold and deductible, TRIA provides for a taxpayer provided backstop for terrorism coverage. What is the value of this backstop for insurance companies (if a nominal figure cannot be determined, please indicate if it is more than zero)?

A.3. The value of the backstop cannot be quantified. Nonetheless, it may be helpful to view the value of TRIA (to insurers, insurance consumers, the public, and the broader U.S. economy) from the perspective of the negative consequences that might be expected should TRIA expire at the end of 2014. First, the Federal Government would lose the private market buffer of insured losses under TRIA. Coupled with the likely reduction or rationing of insurance capacity by individual insurers, this has the potential to turn Federal disaster assistance into a more viable source of economic stability after a terrorism event. It would likely be subject to the Federal appropriations process and, thus, distributed more slowly. And, unlike under TRIA, the Federal funds expended would not be recouped. Second, we could expect to see a delay or reduction in the number of construction projects, where commercial development and financing depends on the availability of adequate terrorism risk insurance. Third, businesses seeking terrorism risk insurance coverage are likely to see fewer policy options available, and, where coverage is available, it is likely to reflect the true cost of the risk absent the Federal high-level backstop.

Q.4. Should the American taxpayers be compensated for the risk through TRIA with front-end premiums?

A.4. To be clear the current program requires that American taxpayers be compensated. Under the current program, they are compensated on a post-event basis. That said, TRIA is designed to protect the American economy by maximizing the amount of risk that can be kept safely within the insurance industry. The program provides solvency protection for the industry by serving as a safety net to prevent widespread insurer failures, volatility in capacity, and pricing swings. TRIA is not intended to serve as a "working layer" of coverage for normally insurable levels of loss; it is a catastrophic terrorism backstop that adds otherwise unavailable capacity.

TRIA includes a post-event recoupment feature which (combined with high individual insurer retentions) ensures that the Federal Government only participates in catastrophic loss scenarios.

If the program were shifted to a pre-funded premium basis, the up-front costs of terrorism coverage for America's businesses and local governments increase by definition. Basic economic principles hold that increases in the upfront cost of terrorism insurance will drive down policyholder take-up rates, reduce available capacity and diminish the other economic benefits that flow from the current TRIA structure. Further, the post-event burden on the Federal Government will increase with the decrease in insurance coverage, at the same time slowing the growth of important sectors of the economy that depend on the availability of terrorism risk insurance, such as construction, real estate, manufacturing, infrastructure and small business generally.

Q.5. TRIA is intended to protect the insurance industry from insolvency in the case of catastrophic losses due to a terrorism event. Currently, TRIA is triggered after $100 million in aggregate industry losses in a single year.

Would you consider $100 million in industry-wide losses a catastrophic loss that threatens the solvency of the insurance industry? If not, what would that amount be?

A.5. No. $100M in industry-wide losses would not threaten the solvency of the property-casualty industry. However, it is important to remember that $100 million in industry losses only triggers the Terrorism Risk Insurance Program, not the Federal Government's share of the losses. As discussed, the combination of high individual insurer retentions (deductibles and co-shares) and the mandatory recoupment in TRIA ensures that the Federal Government will only participate in catastrophic loss scenarios. In addition, raising the program trigger would likely decrease terrorism-insurance capacity. Speaking for The Hartford, our program deductible is approximately $1.2 billion, so an increase in the trigger below that amount would not substantially impact the capacity we can offer in the market. The same is obviously not true for smaller insurers, whose deductibles are closer to the existing trigger. But saying that raising the trigger would not negatively impact our capacity is not the same as saying it would incent more private market participation.

Additional Material supplied for the Record

IMPORTANCE OF TERRORISM RISK INSURANCE

MR. BLUMENTHAL. Mr. Chairman, I thank you for holding this hearing, which will hopefully draw attention and support to the Terrorism Risk Insurance Act, known as TRIA. I also want to thank Douglas Elliot from the The Hartford for testifying and helping us better appreciate the unique nature of this particular insurance market. In the wake of the horrific events of 9/11, the nation understood that it faced new threats, potentially endangering both human life and property on a vast scale. As a member of the Armed Services Committee, I have worked with my colleagues to strengthen our country's preparedness against terrorist threats. Addressing the risk of terrorism is not only about our military, our diplomacy, or our intelligence networks. It's also about our economy and our financial system.

Added to the horrific human costs, the economic costs of 9/11 were devastating. The insurance industry alone faced tens of billions of dollars in losses. The sheer scale and scope of terrorist-attack damage makes it unlike other events we typically insure against. The very fact that such events are, thankfully, so rare, makes their financial risks extremely difficult to assess. The difficulty of building reliable actuarial models for such risks creates uncertainties for insurers. These uncertainties impact the broader economy, especially when insurers cannot provide protection for businesses, property owners, builders, and others. That is why a functioning market for terrorism risk insurance needs strong public involvement, and why, particularly while the economic recovery remains fragile, there should be no delay in extending TRIA.

This program has attracted overwhelming bipartisan support for a simple reason: it works. By implementing a last-resort public backstop while requiring meaningful risk-sharing from the private sector, TRIA lays the foundation for a functioning market, protects taxpayers, and keeps our economy running smoothly in an uncertain world. In states like Connecticut, which unfortunately have felt the impact of acts of terrorism, we know the critical importance of assuring that properties judged as high-risk have coverage and that a backstop is in place.

As we take this opportunity to closely examine TRIA, I urge my colleagues to recognize the tremendous importance of this program and to come together to extend it.

Independent Insurance Agent®

STATEMENT OF THE
INDEPENDENT INSURANCE AGENTS & BROKERS OF AMERICA

U.S. SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

"REAUTHORIZING TRIA: THE STATE OF THE TERRORISM RISK INSURANCE MARKET, PART II"

FEBRUARY 25, 2014

The Independent Insurance Agents & Brokers of America (IIABA or the Big "I") is the nation's oldest and largest trade association of independent insurance agents and brokers, representing a network of more than a quarter of a million agents, brokers, and employees nationwide. Big "I" member small businesses possess the unique ability to offer consumers a wide array of insurance products – property, casualty, health and life – from many different insurance companies. Independent agents sell nearly 80% of all commercial lines policies in the country, and our expertise and experience with businesses and the commercial marketplace affords our membership a one-of-a-kind perspective with which to speak to the topic of terrorism insurance.

The scheduled expiration of the Terrorism Risk Insurance Program Reauthorization Act (TRIPRA) at the end of 2014 is quickly approaching, and IIABA applauds the Committee for continuing its important review of the Terrorism Risk Insurance Program (TRIP). Although the threat of unprovoked, unpredictable, and possibly devastating attacks continues to loom large and create complex and unique challenges for insurance providers, the existence of the TRIP has successfully helped preserve a stable and viable market for terrorism insurance.

The Big "I" believes that reauthorizing the public-private partnership is vitally important to maintaining the stability of the commercial property-casualty insurance markets. In the view of the IIABA, the program should be reauthorized well ahead of the scheduled expiration date. Any possible reforms to the program should be carefully weighed against any number of negative, unintended consequences in the private marketplace and the broader economy. The Big "I" looks forward to working with members of the Committee as the reauthorization process unfolds.

The Terrorism Risk Insurance Program

The enactment of the Terrorism Risk Insurance Act (TRIA) in November 2002 and the subsequent establishment of TRIP were key elements of the federal government's response to the heinous and devastating attacks of September 11, 2001.

The attacks quickly produced severe disruptions in the insurance marketplace and in the broader national economy. Insurers were forced to confront the reality that large terrorism events could indeed occur and that they posed unique risks. The underwriting and pricing of these exposures proved nearly impossible due to the inability of carriers to assess and measure the likelihood and magnitude of future terrorism events, and many insurers simply stopped providing terrorism coverage to commercial policyholders as a result. The inability of businesses to secure adequate terrorism coverage also had significant and negative repercussions across broad sectors of the national economy. The commercial real estate market, for example, was acutely affected as insurance for new construction projects could not be obtained and therefore funding from lenders could not be secured.

The original enactment of TRIA and its extension in 2005 and again in 2007 successfully stabilized the insurance marketplace and helped eliminate the market disruptions and uncertainties that followed the September 11th attacks. Congress wisely provided a program structure that involves the private sector as much as possible and created a successful and limited public-private partnership that has operated at virtually no cost to taxpayers. The private sector remains solely responsible for terrorism-related losses related to personal insurance (auto and homeowners), group life, reinsurance, and numerous other lines of coverage.

TRIP also has numerous cost sharing provisions that limit the exposure of the federal government should the worst happen and a need for the backstop arise. In fact, the federal government would be completely repaid, with significant interest, by private market participants in all but the most catastrophic scenarios.

Ongoing Need for TRIP

The Big "I" believes the continued operation of TRIP is essential given the persistent threat of terrorism and the unique and unpredictable nature of this devastating risk. The factors and marketplace realities that caused Congress to initially enact and subsequently reauthorize the program remain in place today. Furthermore, the marketplace outcomes that have resulted from the program's existence over the last eleven years would be hard to improve upon.

As the Boston Marathon bombings sadly reminded us, the threat of terrorism has not diminished over the years. Our law enforcement and national security officials have done an admirable job thwarting attacks, but this has not lessened the appetite for our enemies to do us harm through physical, economic and psychological means.

Terrorism is also a risk that is unique from all others for a number of reasons. Insurers simply do not have access to the data and information to perform proper underwriting, as much of the information that does exist on planned or thwarted attacks is classified for understandable national security reasons. In addition, the amount of publicly available data is limited due to the fact that there have thankfully been very few successful terrorist attacks. Finally, unlike other risks such as natural disasters, previous terrorist attacks do not provide optimal data points for the underwriting process as terrorists seek to make their attacks as unpredictable and destructive as possible.

It is also important to note that this is not an issue that affects only urban areas. In essence any location where large crowds gather is a potential terrorist target. The most obvious examples are large buildings in major American cities, but perhaps less often noted examples are shopping malls, sports stadiums and auditoriums just to name a few. These exist all across the country, and it is for this reason that every member of Congress should be concerned about the reauthorization of TRIP.

Possible Reforms

The Big "I" believes that TRIP should be reauthorized as soon as possible, and that the current program strikes a careful balance between fostering a stable and viable private marketplace while providing for a limited federal role. It is important to take into account that the private market capacity in existence today is available because of the TRIA program, not in spite of it.
The program likely does have room for improvement in some technical aspects, such as the certification process for determining what is or is not a terrorist attack for the purposes of TRIP. Beyond this, and particularly when concerning the various cost sharing mechanisms, IIABA urges caution as any changes could produce the opposite of the intended effect in the form of reduced private market capacity and/or a destabilized marketplace.

Likely the most widely discussed ideas on Capitol Hill for attempting to inject additional private capital into the markets involve amending the various existing cost-sharing mechanisms in the program. At first blush, these ideas are understandably attractive to some policymakers. They are easy to grasp and convey, and would use existing triggers and mechanisms in the law to attempt to increase "skin in the game" from insurers. However, the Big "I" urges caution when considering amending any these provisions for a number of reasons.

Amending the cost sharing measures could have any number of unintentional negative effects such as creating market imbalances and decreased capacity, squeezing out smaller insurers or those companies who are already at their maximum exposure limits. These are of course exactly the opposite private market outcomes the Big "I" and the Committee are looking to create. The Big "I" urges the Committee to conduct detailed discussions with insurers of all sizes and exposure levels to ensure no unintended consequences are experienced by commercial policyholders.

Conclusion

The Big "I" again thanks the Committee for its leadership on this issue. IIABA believes that TRIP has worked well over the years and that the program is much needed to maintain a stable and viable market for terrorism insurance. If the Committee must move forward with reforms, the Big "I" urges caution against any unintended marketplace outcomes and to consider the effects on insurers of all sizes and marketplace exposures. IIABA stands ready to assist during the reauthorization process and appreciates the Committee's consideration of our views.

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Aon plc

Written Testimony Submission

February 25, 2014

Senate Banking Committee

Reauthorizing TRIA: The state of the Terrorism Risk insurance Market, Part II

As the leading global (re)insurance broker, Aon plc, is in a unique position to assess the marketplace for terrorism risk specifically related to affordability and availability. Aon data supports the contention that the Terrorism Risk Insurance Act (TRIA) program is essential to ensuring that terrorism cover is available and affordable for U.S. clients. To assess the marketplace we rely on the Aon GRIP data base[1], the world's largest global repository of risk and insurance placement information. GRIP measures in excess of $94 billion in bound premium, the results of policy placements from over 750 insurers to medium and large businesses across all sectors of the economy.

Given the history of the public policy discussion related to TRIA reauthorization, there is little doubt that expiration would cause severe economic dislocation. Indeed, there is already evidence that insurers are protecting themselves from this eventuality with policy endorsements and exclusions. For example, the National Council on Compensation Insurance has secured a general endorsement for workers compensation policies indicating that pricing for workers comp could radically change without TRIA[2]. Aon expects similar developments in the property market and know from past experience that insurers will demand contingencies allowing them to reprice policies should TRIA not be reauthorized, or be modified in a way that changes the risk profile of the coverage. Beyond the threshold question of whether or not to continue TRIA in some form or fashion, Aon's clients recognize that alterations to the program trigger or carrier deductibles would generate a transfer of additional cost to insureds beyond premiums already ceded which is difficult to quantify.

TRIA remains the only viable solution for handling the full quantum of terrorism insurance exposures in the United States at a price that allows businesses of all size to avail themselves of the cover.

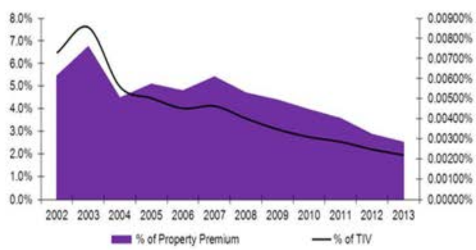
[1] Terrorism Categories measured by Aon's GRIPTM benchmarking database are:
1) Standalone Terrorism - all standalone terrorism for clients with US and/or non US values. Generally purchased by the highest risk Aon clients who cannot secure terrorism coverage via TRIA as property markets price themselves out of the mandatory offer or decline to quote
2) TRIA only - embedded terrorism (part of property placement) for US risks only. Typically, lowest risk Aon clients.
3) TRIA and Non Certified - embedded terrorism (part of property placement) for US risks (TRIA) and non US risks (foreign) – i.e., clients with foreign values, but generally not considered target portfolios. Non Certified can also be a reference to US only risks, wherein the markets are providing embedded terrorism to cover the USD 5 million Certification Trigger under TRIA (i.e., coverage for acts of terrorism that don't meet the USD 5 million combined Insured Loss P&C trigger under TRIA)
4) Standalone and TRIA - mix of both by layer or clients using an onshore "TRIA Captive" structure to access TRIA directly and then reinsuring retained US TRIA exposures via standalone terrorism markets (as well as non US via standalone). Also typically the highest risk Aon clients or clients requiring high terrorism limits.
5) "Take-Up Rate" refers to those Aon clients electing to purchase some form of terrorism coverage.

[2] NCCI "Notification Endorsement of Pending Law Change to TRIPRA" WC 00 01 14 (Ed. -8-13). Appendix A

Economic Impact: Terrorism Pricing Ensures a Path to Affordability

By any measure, TRIA has been the key driver ensuring the availability and affordability of terrorism insurance in the United States. The public/private partnership providing $100 billion of reinsurance capacity to the property and casualty (P&C) insurance industry provides not only needed terrorism insurance capacity, but also a unique, mandatory offer of terrorism coverage to all commercial P&C buyers seeking to purchase terrorism coverage. The importance of TRIA's mandatory offer – requiring insurers to offer terrorism coverage does not materially differ from the underlying terms, conditions and deductibles of the P&C insurance to which it attaches – is the basis of the market. TRIA's positive impact on terrorism insurance pricing is clearly demonstrated in the chart below[3], with property terrorism pricing declining, on average, by close to 50 percent in the period running from 2002 to 2013 (YE). At the same time, take-up has remained steady suggesting a fairly mature market readily understood by market participants.

Exhibit 1- Median Terrorism Premium as a Percent of Property Premium
Source: Aon Data



Absent the program, the insurance market has repeatedly signaled that it will not offer the same level of terrorism coverage. This is not speculation but rather is backed by firm insurance carrier behavior in the run-up to the Act's prior expirations, and this process has begun again for insureds that have begun to negotiate insurance contracts that extend beyond 2014. At the same time that the price of terror cover is coming down, recent market data including renewals completed in Q1 2014, trends indicate that pricing for terror coverage has only *flattened* while pricing *declines* for other components of property coverage continue. These factors suggest that the uncertainty created by the TRIA's impending expiration produces increased costs for U.S. business. Timely reauthorization is expected to create an environment where terrorism risk pricing will continue to decline in alignment with the cost of other property components.

[3] Pricing in the reference chart is expressed as a percentage of median terrorism premium divided by median property premium, which is a preferred measure of terrorism costs for insureds as terrorism, following the events of 9/11, has become an added cost that is weighed and measured by all P&C insurance buyers.

Aon Property Broking's GRIP® database assigns two measures to pricing for terrorism risk: as a "percentage of Total Insured Values" (rate-based) or as a "percentage of Property Premium" (typical measure used by insureds). The former is a simple calculation of terrorism premium divided by Total Insured Values (or "TIV," which represents combined Property Asset values and Business Interruption values). The latter is a function of total terrorism premiums divided by total property premiums, expressed as a percentage.

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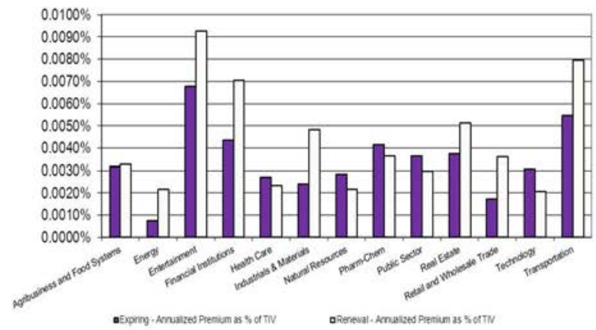
Additionally, as insurers are forced by regulators and rating agencies to manage terrorism risk in an environment of uncertainty, carriers have begun to scale back capacity for terrorism risk in 2013. For example, Fitch Ratings warns, in a July 2013 Special Report, "Although private market standalone terrorism coverage has increased over time, it is unlikely that substantial private market capacity would arise as a substitute to TRIA coverage if the program is allowed to expire. This has led to a classic "supply versus demand" equation with reduced capacity leading to pricing increases for terrorism in 2013. Per the chart below, terrorism pricing increases for property insurance have been most notable for clients with high terrorism risk profiles that need to use both "Standalone" and "TRIA" coverage to build adequate terrorism limits in industry subsectors tracked by Aon GRIP benchmarking, most notably for Entertainment, Financial Institutions, Industrials & Materials, Real Estate and Transportation subsectors.

Exhibit 2-Terrorism Insurance Expiring vs. Renewal Pricing by Industry
Twelve Months Ending 12/31/13
Source: Aon Data



It is expected that pricing volatility will increase going forward and will become particularly acute as major insurance contracts come up for renewal in 2014 since a portion of the contract will extend beyond TRIA's scheduled expiration on December 31, 2014. If the prior two extensions of TRIA are any indication, it is expected that a decision on whether to extend TRIA, substantially modify TRIA or allow TRIA to expire will not be clear until well into 2014. This will have a further detrimental impact on terrorism pricing as both insureds and their major insurance P&C trading partners will not have any degree of certainty regarding the state of the terrorism market—potentially until December 2014, as the prior two extensions did not take place until December of 2005 and 2007.

Should TRIA be allowed to expire, the removal of the mandatory offer of coverage and the limited market for alternatives to embedded TRIA coverage will eliminate the only certain source of continued availability and, more importantly, affordability for major buyers. Without the embedded TRIA coverage, there will no longer be

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a functional market for commercial property terrorism coverage. We do not believe that there is a legitimate alternative in the absence of extension.

Modifications to TRIA

Congress must consider carefully any modifications to TRIA that could constrict availability or sharply increase price. Changes to the program trigger or the company deductible would certainly adversely impact insurers of all sizes as an increasing amount of their policy holder surplus (PHS) is dedicated to terror cover. Keeping in mind that under TRIA, terror cover *must be offered at commercially viable rates,* modifications to program trigger and/or company deductible levels can have a very real impact on the health of market participants.

Program trigger in relation to PHS is important given the chance that only a single insurer is affected by a terrorism event. In that case, the insurer bears the net loss up to the program trigger regardless of the TRIA deductible. The table below demonstrates the impact that an increase in the trigger has on small insurers. At the current rate of $100 million, 7.7 percent of insurers in Aon's GRIP database have 20 percent of their PHS exposed to terrorism events. As the deductible rises, the percentage of insurers who will have 20 percent or greater of their PHS dedicated to the trigger grows sharply and the smaller the company (the less PHS) the faster the notional trigger devours surplus.

Exhibit 3- Program Trigger as Percent of Policy Holder Surplus
Source: SNL

Program Trigger as % of PHS		> 20%	10% - 20%	< 10%
Current Trigger = $100M	# of Companies	638	46	69
	% of Total	*84.7%*	*6.1%*	*9.2%*
	2013Q3 Prem	19,894,242	17,356,047	110,764,728
	% of Total	*13.4%*	*11.7%*	*74.8%*
	PHS	46,457,587	32,806,436	525,033,193
	% of Total	*7.7%*	*5.4%*	*86.9%*
Revised Trigger = $250M	# of Companies	691	29	33
	% of Total	*91.8%*	*3.9%*	*4.4%*
	2013Q3 Prem	40,301,889	17,526,605	90,086,523
	% of Total	*27.2%*	*11.9%*	*60.9%*
	PHS	87,288,419	52,735,326	464,273,470
	% of Total	*14.4%*	*8.7%*	*76.8%*
Revised Trigger = $500M	# of Companies	718	13	22
	% of Total	*95.4%*	*1.7%*	*2.9%*
	2013Q3 Prem	57,494,934	16,286,822	74,233,281
	% of Total	*38.8%*	*11.0%*	*50.2%*
	PHS	134,990,558	50,494,269	418,812,389
	% of Total	*22.3%*	*8.4%*	*69.3%*
Revised Trigger = $1B	# of Companies	728	15	10
	% of Total	*96.7%*	*2.0%*	*1.3%*
	2013Q3 Prem	69,015,019	30,063,664	48,936,334
	% of Total	*46.6%*	*20.3%*	*33.1%*
	PHS	598,396,708	1,179,690	4,718,617
	% of Total	*99.0%*	*0.2%*	*0.8%*

Similarly, modifications to the TRIA deductible can have a deleterious impact on the health of insurers. The financial strength of an insurer is measured by the risk it bears in relation to the capital it holds. In the past, rating agencies have identified concerns about the financial stability of insurers for which any single risk makes up 10 percent or greater of their PHS.

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Exhibit 4[4] shows at current deductible levels that almost one-third of companies in the database have a deductible of greater than 10 percent of PHS representing 45 percent of total industry premium and 13 percent of the total capital. As the deductible increases as a percentage of premiums, a larger portion of the industry falls into the "greater than 10 percent" of PHS category. Using the GRIP database, Aon has forecasted scenarios of escalating deductibles, both for property and workers compensation. The Aon data demonstrates that increasing deductibles beyond current levels forces an increasing number of companies into the 10 percent "danger zone," creating the possibility of downgrades of insurers.

Exhibit 4- TRIPRA Deductible as percent of Policy Holder Surplus
Source: SNL

TRIPRA Deductible as % of PHS		> 20%	10% - 20%	< 10%
Current Deductible Prop 20% WC 20% of DEP	# of Companies	121	[illegible]	[illegible]
	% of Total	16.1%	[illegible]	67.9%
	2013Q3 Prem	20,274,394	41,244,329	80,480,094
	% of Total	17.8%	27.7%	54.4%
	PHS	10,281,004	63,328,984	524,087,132
	% of Total	2.7%	16.5%	80.8%
TRIPRA Deductible Prop 25% WC 20% of DEP	# of Companies	145	130	473
	% of Total	19.3%	17.3%	62.8%
	2013Q3 Prem	29,573,577	63,221,273	56,286,197
	% of Total	19.9%	47.7%	38.0%
	PHS	23,032,008	151,732,984	470,505,743
	% of Total	3.3%	17.9%	77.6%
TRIPRA Deductible = Prop 25% WC 25% of DEP	# of Companies	160	135	459
	% of Total	21.1%	17.9%	60.9%
	2013Q3 Prem	35,334,004	63,678,150	49,622,797
	% of Total	23.9%	42.6%	33.5%
	PHS	27,005,182	122,343,348	454,918,[illegible]
	% of Total	4.5%	20.2%	75.3%
TRIPRA Deductible Prop 30% WC 20% of DEP	# of Companies	166	144	413
	% of Total	22.0%	19.1%	58.8%
	2013Q3 Prem	36,064,384	61,549,250	50,385,177
	% of Total	24.4%	41.6%	34.0%
	PHS	28,352,401	119,509,342	456,316,[illegible]
	% of Total	4.7%	19.8%	75.5%
TRIPRA Deductible = Prop 30% WC 25% of DEP	# of Companies	180	141	432
	% of Total	23.9%	18.7%	57.4%
	2013Q3 Prem	37,896,473	64,023,564	46,066,531
	% of Total	25.6%	43.3%	31.1%
	PHS	30,686,892	128,207,918	445,692,219
	% of Total	5.1%	21.2%	73.7%

Workers Compensation

Following the aftermath of 9/11, insurers began to collect employee concentration data as a critical component of the underwriting submission. Insurers created underwriting models which track exposure to human concentration in geographies perceived to be prone to loss, such as major metropolitan centers, corporate headquarters and other institutions of significance. To further amplify the actions taken by NCCI mentioned earlier is this statement, recently the New York State Fund restricted an offer to a New York client to provide insurance only up until December 31, 2014. While the fund is able to offer credits to clients to make bids more competitive, the state removed all credits from the quote amounting to a 67 percent price increase.

4 Figures are based on publicly available information which may be incomplete in regards US premium; exhibit should be viewed mainly for comparative purposes

Aon is confident that without TRIA or similar reinsurance capital, the cost of workers' compensation insurance will be significantly higher, if available at all. Aon has noted recent market action where a single yet important insurer curtailed its willingness to provide workers' compensation coverage to "high risk" enterprises. These enterprises experienced cost increases of double or greater. Aon concludes that TRIA expiration would have a significantly greater negative impact to the market than the actions of a single insurer. Further, Aon anticipates the cost impact would penetrate much deeper into the market and affect all companies—not just companies that present high risks to the market. To the extent that legislators feel that TRIA is a regional need, the economics of the workers compensation market dispels this myth. The fact that terrorism cannot be excluded from "comp" policies will force insurers to substantially tighten underwriting and constrict offers. Insurers writing in metropolitan areas will have precious little capacity to extend to suburban markets and smaller/regional insurers may exit the market completely rather than "bet their company" that terrorism is only an urban concern.

Conclusion

Since its inception in 2002, TRIA--in its various forms--has increasingly shifted the risk of terrorism loss to the private market. But the program has also had the benefit of requiring insurers to offer terrorism coverage. If TRIA is allowed to expire without replacement and the mandatory offer of coverage disappears, Aon anticipates a notable market contraction. This statement is not supposition—it has been documented by carrier behavior leading up to prior TRIA expirations: nearly 85 percent of property insurance carriers look to exclude terrorism in the absence of TRIA. Should TRIA expire, it would be expected that more capital would enter the market in the form of specialty standalone terrorism insurers, but this capital would not come close to approximating the US $100 billion of contingent reinsurance capital provided by TRIA. Finally, it is highly unlikely that risk models will improve to a level that satisfies the primary concerns of (re)insurers: the ability to accurately forecast terrorism accumulation exposures, the range of potential loss scenarios and, most importantly, the size and frequency of potential losses.

Based on Aon's marketplace experience, the key drivers of capacity and pricing for terrorism insurance and reinsurance outlined above are intertwined to varying degrees with no one factor outweighing another. All of the factors lead to the conclusion: the marketplace for terrorism risk that would exist in TRIA's absence would be constrained by capacity shortfalls, higher pricing and would ultimately provide a disincentive for insureds to purchase terrorism insurance. Put another way, TRIA creates a private market for terrorism risk which reinforces and sustains the continued existence of this private market.

Finally, and most importantly, the risk of terrorism loss remains very present in the United States and globally. Without TRIA's economic safety net, a successful terrorism attack will have long-ranging impact on the U.S. economy, with no underlying framework to encourage private market participation to assume the ever-present terrorism risk.

Appendix A-NCCI "Notification Endorsement of Pending Law Change to TRIPRA" WC 00 01 14 (Ed. -8-13)

WORKERS COMPENSATION AND EMPLOYERS LIABILITY INSURANCE POLICY — WC 00 01 14

(Ed. 08-13)

NOTIFICATION ENDORSEMENT OF PENDING LAW CHANGE TO TERRORISM RISK INSURANCE PROGRAM REAUTHORIZATION ACT OF 2007

This endorsement is being sent to you with respect to your workers compensation and employers liability insurance policy. This endorsement does not replace the separate Terrorism Risk Insurance Program Reauthorization Act Disclosure Endorsement (WC 00 04 22 A) that is attached to your current policy and which remains in effect as applicable.

The Terrorism Risk Insurance Act of 2002 (TRIA) as previously amended and extended by the Terrorism Risk Insurance Program Reauthorization Act of 2007 (TRIPRA), provides for a program under which the federal government will share in the payment of insured losses caused by certain acts of terrorism. In the absence of affirmative US Congressional action to extend, update, or otherwise reauthorize TRIPRA, in whole or in part, TRIPRA is scheduled to expire December 31, 2014.

Since the timetable for any further Congressional action respecting TRIPRA is unknown at this time, and exposure to acts of terrorism remains, we are providing our policyholders with relevant information concerning their workers compensation policies in effect on or after January 1, 2014 in the event of TRIPRA's expiration.

Your policy provides coverage for workers compensation losses caused by acts of terrorism or war, including workers compensation benefit obligations dictated by state law, except in Pennsylvania where injuries or deaths resulting from certain war-related activities are excluded from workers compensation coverage. Coverage for such losses is still subject to all terms, definitions, exclusions, and conditions in your policy.

The premium charge for the coverage your policy provides for terrorism or war losses is shown in Item 4 of the Information Page or the Schedule in the Terrorism Risk Insurance Program Reauthorization Act Disclosure Endorsement (WC 00 04 22 A) that is attached to your policy, and this amount may continue or change for new, renewal, and in-force policies in effect on or after December 31, 2014 in the event of TRIPRA's expiration, subject to regulatory review in accordance with applicable state law.

You need not do anything further at this time.

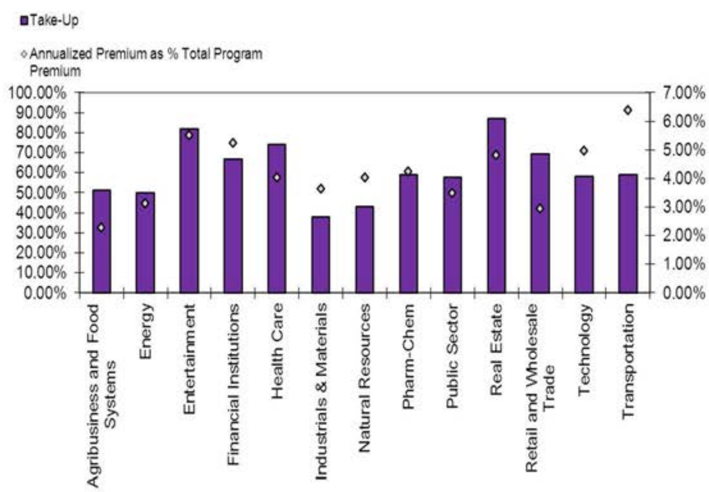
This endorsement changes the policy to which it is attached and is effective on the date issued unless otherwise stated.

(The information below is required only when this endorsement is issued subsequent to preparation of the policy.)

Endorsement Effective	Policy No.	Endorsement No.
Insured	Insurance Company	

Countersigned By ____________________

Appendix B-Terrorism Insurance Take-Up and Pricing by Industry
Twelve Months Ending 12/31/13
Source: Aon Data



FINANCIAL SERVICES ROUNDTABLE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
UNITED STATES SENATE

Reauthorizing TRIA: The State of the Terrorism Risk Insurance Market, Part II

February 25, 2014

The Financial Services Roundtable ("FSR") thanks Chairman Johnson and Ranking Member Crapo for holding this important hearing entitled "Reauthorizing TRIA: The State of the Terrorism Risk Insurance Market, Part II" We applaud your consideration of Terrorism Risk Insurance Act ("TRIA") and appreciate the opportunity to submit comments for the record.

FSR supports the long-term reauthorization of TRIA. TRIA establishes a public-private partnership that enables the private sector to offer terrorism risk insurance and absorb substantial property and casualty losses resulting from acts of terrorism. Under this framework, FSR believes TRIA achieves its public policy goals of supporting a private market for terrorism risk insurance, fostering economic resiliency before and after a terrorist attack, and limiting taxpayer losses following a terrorist attack against the nation.

This hearing is an important step in assessing the program and informing policymakers about this marketplace for terrorism insurance coverage. The last time Congress voted on TRIA was in 2007, and many of the Financial Services Committee members have never considered this program.

FSR represents 100 of the largest integrated financial services companies providing banking, insurance, investment products and services to the American consumer. FSR member companies fuel America's economic engine, accounting directly for $92.7 trillion in managed assets, $1.2 trillion in revenue, and 2.3 million jobs.

Our diverse membership gives FSR a unique perspective on TRIA. FSR member companies not only include the insurers and reinsurers that offer terrorism coverage, but also banks and investors that must protect their investments from terrorism-related events, companies that need workers compensation protection for their employees and the very policyholders that must insure against terrorism loss. TRIA was not established for insurers, but rather for policyholders – investors, developers, lenders, and employers, all of whom drive economic growth and create jobs.

TRIA BACKGROUND

Congress approved the Terrorism Risk Insurance Act of 2002 on November 26, 2002, after private terrorism insurance constricted following the terrorist attacks of 2001. The September 11, 2001, attacks totaled approximately $31.6 billion (in 2001 dollars), and Congress enacted TRIA in response to widespread concern that the lack of terrorism insurance would have a tangible adverse impact on the U.S. economy.

TRIA was a three year program authorized through 2005 and then reauthorized again in 2005 and 2007 in recognition of the ongoing terrorist threat and the inability of insurers to underwrite the threat and make a sufficient private market for terrorism coverage. The existing law is set to expire on December 31, 2013.

TRIA'S FRAMEWORK

TRIA ensures that the private sector offers terrorism risk coverage and ultimately absorbs some if not all of the loss from an attack. Extraordinary losses that exceed substantial private funding levels will be shared between the private and public sector, as outlined below. The existing program's structure requires substantial private sector capital before any public money becomes involved, and that public money which may be called upon is subject to a meaningful recoupment formula.

TRIA only covers certified acts of terrorism (as determined by the U.S. Department of the Treasury), requiring, among other things, property and casualty losses that exceed $5 million. The current version of TRIA has a "program trigger" of $100 million, under which the private sector absorbs all loss. If losses exceed $100 million, each individual insurance company will realize the entire loss up to 20 percent of its previous year's annual direct written premiums from commercial and property lines (this is the program deductible). Though that deductible varies depending on the premiums written, it is currently estimated to be approximately $34 billion.[1]

If losses exceed this level, private insurers begin to share losses with the federal government; the government absorbs 85 percent of additional losses and the private sector absorbs the remaining 15 percent. In effect, this government participation is a liquidity mechanism, where the government payments, should there be any, provide immediate liquidity to the insurer, allowing policyholders and claimants to receive insurance claims payments quickly. The law requires that government will recoup from insurers 133 percent of public funds provided up to $27.5 billion; losses above that amount are subject to recoupment in the government's discretion. Government funding for events that occur after January 1, 2012, must be collected by September 30, 2017, under current law.

TERRORISM RISK CANNOT BE UNDERWRITTEN

Terrorism is a risk, particularly for major attacks that could lead to massive damages, that cannot be underwritten at the present time. Effective insurance underwriting requires the ability to predict the frequency, location, and severity of loss. Though the typical insurance risks can be unpredictable, when those events are pooled over a large enough area and timeline, the randomness of those events can provide a better understanding of the frequency and severity and location of events and inform underwriting, pooling and risk management decisions by insurers.

Terrorism, however, presents an additional complication because it is purposeful, and indeed, the very nature of terrorism is to evade prediction. Insurers continue to seek modeling methodologies; however, underwriters have yet to identify a proven model that can work with existing and available data to predict this risk in an accurate enough way with the erratic and purposeful behavior of terrorists. The industry, thankfully, lacks meaningful data regarding severity, nature, extent, impact or duration of Nuclear, Chemical Biological, and Radiological (NCBR) attacks. Neither the frequency nor severity of an attack can currently be accurately predicted or credibly modeled. A terrorist may not act for years and then strike multiple times in multiple different ways and locations, none of which is predictable. This lack of predictability is compounded by the fact that terrorism is a dynamic risk: "Terrorism involves strategic human behavior and represents a dynamic threat that is intentional, responsive to countermeasures, and

[1] Webel, Baird. Congressional Research Service. Terrorism Risk Insurance: Issue Analysis and Overview of Current Program. April 26, 2013.

purposefully unpredictable."[2] To the extent that the terrorist threat is identified, the threat is likely to evolve and change to avoid being thwarted. This risk, perversely driven by human creativity and unlimited in scope, makes underwriting terrorist risk an impossibility. Furthermore, terrorists seek to disguise intent and their planned actions making it even more difficult to predict attacks or outcomes.

Without TRIA, the insurance industry's ability to insure property or absorb losses following a severe terrorist attack will be severely compromised. This is compounded by the state law requirement to cover workers compensation coverage. Regardless of whether TRIA is reauthorized, workers compensation must be covered. This leaves coverage providers vulnerable to substantial downside risk from terrorist attacks, including non-conventional NCBR attacks. Without TRIA in place, this downside risk related to workers compensation coverage jeopardizes the solvency of insurers, potentially leaving policyholders unprotected in the aftermath of a tragedy.

If TRIA expires, private sector capacity will diminish significantly, as exhibited in the months after September 11, prior to TRIA's enactment. The lack of market capacity will result in very limited and costly coverage options. This will impact the ability of entities to access coverage necessary to secure financing and investment, to proceed with development, to secure mandatory workers compensation coverage and to protect the businesses that are critical to our economy. It is, therefore, critical that the U.S. continues to partner with the insurance industry to assure policyholder access to critically important coverages.

TERRORISM RISK INSURANCE MARKETPLACE

The Financial Services Roundtable and its member companies share the Committee's goal of creating a robust private marketplace for terrorism risk insurance. The nature of terrorism risk, however, is unique and without TRIA no such marketplace would exist at this time.

Take-up Rates

The marketplace and take-up rate for terrorism risk insurance has evolved substantially since the inception of the program. According to Marsh's 2013 study, "In 2003, the first full year TRIA was in effect, the take-up rate was 27 percent but has since increased steadily, remaining in the low 60 percent range since 2009." Take-up rate varies between sectors and regions and company size.

Pricing for terrorism risk has also evolved over the life of the program. Initially, coverage was priced at approximately 7 percent of property premium during the third quarter of 2003. Over time, however, price levels declined, ultimately stabilizing between 3 – 5 percent of property premium range. Price levels, of course, vary according to the size location, and industry.

[2] Hubbard, Glenn and Bruce Deal. *The Economic Effects of Federal Participation in Terrorism Risk.* September 2004.

Capacity

Under TRIA, primary writers in the commercial space are mandated under the "make available" provision to offer terrorism risk coverage; policyholders, however, are not required to purchase the coverage (absent state requirements for coverages such as workers compensation or lender requirements as part of a commercial mortgage). Given the "make available" mandate, primary commercial writers provide the capacity or coverage that would not exist otherwise.

Reinsurance influences the availability of terrorism risk insurance because the transfer of risk from insurer to reinsurer allows the insurer to spread its risk and frees up capital, which allows insurers to provide additional capacity to the marketplace. According to the 2010 President's Working Group Report, reinsurance capacity ranges between $6 - $10 billion. Although capacity may have increased since the report was issued, the available reinsurance coverage does not appear to be sufficient at those or even moderately increased capacity levels.

The private sector continues to explore whether the capital markets could provide addition risk spreading mechanisms for terrorism insurance, thus increasing capacity for primary insurers. To date, however, there is not an active securitization market for terrorism risk. While our members are eager to identify stable sources of additional capital for the market place, there is no viable option to meet demand at this point.

Many risk professionals believe the termination of TRIA would reduce coverage and decrease the affordability and availability of terrorism coverage. According to a poll by the Risk and Insurance Management Society (RIMS), 45 percent of respondents expected a decrease in terrorism coverage limits while 24 percent believed coverage would no longer be offered by insurers upon expiration of TRIA.

The Committee is considering what adjustments should be made to the program to increase the marketplace for terrorism risk insurance, foster economic resiliency before and after a terrorist attack, and limit taxpayer losses following such a tragedy. These are important goals to have top of mind as changes to the program are contemplated. Although the question is not whether available terrorism risk insurance coverage would be sufficient should TRIA expire, any adjustments to the program should be closely scrutinized as to their impact on private sector participation in the market and supply of coverage.

As noted in the above description of TRIA's framework, there are key attachment points to determine when an attack is considered for certification and when public funds must be deployed and then recouped from the private sector. FSR believes that TRIA's current framework effectively accomplishes its public policy goals, but also understands the Committee's goal to increase private sector involvement. This goal, however, and the adjustments made to achieve it, should be weighed against potential harm they do to marketplace capacity and the functioning of the program.

As a result, FSR recommends that any adjustments to the program – whether new ideas or adjustments to existing attachment points – ensure the program is authorized on a long-term basis; continues to function effectively for all market participants; and provides an orderly mechanism to ensure economic resiliency before and after an attack.

Workers Compensation

Under state law, insurers cannot exclude workers compensation from coverage, whether or not TRIA is in place. This leaves insurers vulnerable to substantial downside risk from terrorist attacks, including non-conventional NCBR attacks. Without TRIA in place, this downside risk related to workers compensation coverage jeopardizes the solvency of insurers, potentially leaving policyholders unprotected in the aftermath of a tragedy. Consequently, the workers compensation market may experience a variance in pricing and capacity based on the framework and existence of the program.

Commercial Lending

The market for terrorism risk insurance and the take up rate has important implications for commercial lending because commercial lenders include terrorism risk insurance coverage requirements for loans over a certain size or where the project being financed is in proximity to areas identified as potential targets for terrorist attacks. Lenders have adopted these coverage requirements to help mitigate risk that banks are uncomfortable assessing and ultimately holding. If the terrorism insurance market constricts and reduces policyholders' ability to access terrorism risk coverage, both existing and future commercial loans would be severely affected.

Existing commercial loans that require terrorism risk insurance do not condition a borrower's performance of this requirement on the existence of TRIA or excuse performance if the insurance is unavailable or prohibitively expensive. As many commercial loans span multiple years, even decades, borrowers are required to purchase and renew terrorism coverage for the duration of their loans regardless of whether TRIA is reauthorized or functioning marketplace for terrorism risk insurance exists. If these borrowers and policyholders do not repurchase coverage, they would be in violation of the loan covenant; depending on the contractual language, the lender would be able to call the loan. Borrowers would be forced to purchase coverage no matter how difficult or costly to access, or face consequences for violating the loan covenant. Lenders would be forced to examine each loan and assess whether to call the loan or adjust the terms in some way to mitigate this now unprotected risk. This would result in substantial economic disruption and potential added risk for all participants in the transaction.

For future loans, lenders would assess each loan that triggers its terrorism risk insurance requirement on a case-by-case basis. This would lead to greater uncertainty in the marketplace and put lenders in the business of trying to model terrorism risk – a risk that insurers themselves cannot model at the present time.

CONCLUSION

The Financial Services Roundtable appreciates the Committee holding this hearing. We thank you for the opportunity to submit comments for the record and we look forward to our continued work with the Committee on this important issue.

National Association of Insurance Commissioners & The Center for Insurance Policy and Research

February 25, 2014

The Honorable Tim Johnson
Chairman
U.S. Senate Committee on Banking, Housing, and Urban Affairs
534 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Michael Crapo
Ranking Member
U.S. Senate Committee on Banking, Housing, and Urban Affairs
239 Dirksen Senate Office Building
Washington, D.C. 20510

RE: Terrorism Risk Insurance Act

Dear Chairman Johnson and Ranking Member Crapo:

Thank you for holding this hearing to examine issues regarding the Terrorism Risk Insurance Act (TRIA). We write on behalf of the National Association Insurance Commissioners (NAIC) to reiterate our strong support for TRIA reauthorization and to urge prompt Congressional action to renew this important partnership between the private insurance market and the federal government.

The NAIC is the U.S. standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 states, the District of Columbia and the five U.S. territories. Through the NAIC, state insurance regulators establish standards and best practices, conduct peer review, and coordinate their regulatory oversight. NAIC members, together with the central resources of the NAIC, form the national system of state-based insurance regulation in the U.S.

State insurance regulators believe that a federal partnership with the private insurance markets provides security by minimizing market disruptions and ensuring the widespread availability and affordability of property and casualty insurance for terrorism risks. Further, it does so with minimal financial risk to the U.S. government as the program provides a mechanism to reimburse the federal government for its expenditures. With the expiration of TRIA approaching at the end of this year, the NAIC recommends prompt Congressional action on a long term TRIA reauthorization to help ensure economic stability through the availability of terrorism coverage for commercial policyholders, lenders, builders, and the businesses that operate in areas prone to a terrorist attack.

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www.naic.org

We look forward to working with you as you continue to discuss TRIA reauthorization and would encourage all Members of Congress to discuss the program with their state's insurance commissioner. Should you wish to discuss any matters relating to the NAIC's views on this issue, please do not hesitate to contact Mark Sagat, Counsel and Manager, Financial Policy and Legislation, at (202) 471-3987, or Brooke Stringer, Financial Policy and Legislative Advisor, at (202) 471-3974.

Sincerely,

Commissioner Adam Hamm
NAIC President and
North Dakota Insurance Commissioner

Commissioner Monica Lindeen
NAIC President-Elect
Montana Office of the Commissioner
Of Securities and Insurance

Commissioner Michael F. Consedine
NAIC Vice President
Commissioner
Pennsylvania Department of Insurance

Commissioner Sharon P. Clark
NAIC Secretary-Treasurer
Commissioner
Kentucky Department of Insurance

cc: The Honorable Jon Tester, U.S. Senate
The Honorable Mike Johanns, U.S. Senate

CHAMBER OF COMMERCE
OF THE
UNITED STATES OF AMERICA

R. BRUCE JOSTEN
EXECUTIVE VICE PRESIDENT
GOVERNMENT AFFAIRS

1615 H STREET, N.W.
WASHINGTON, D.C. 20062-2000
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February 24, 2014

The Honorable Tim Johnson	The Honorable Mike Crapo
Chairman	Ranking Member
Committee on Banking, Housing, & Urban Affairs	Committee on Banking, Housing, & Urban Affairs
United States Senate	United States Senate
Washington, DC 20510	Washington, DC 20510

Dear Chairman Johnson and Ranking Member Crapo:

The U.S. Chamber of Commerce, the world's largest business federation representing the interests of more than three million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations, and dedicated to promoting, protecting, and defending America's free enterprise system, thanks you for holding the hearing entitled "Reauthorizing TRIA: The State of the Terrorism Risk Insurance Market, Part II."

In the months following the 9/11 terrorist attacks, the inability for insurance policyholders to secure terrorism risk insurance contributed to a paralysis in the economy, especially in the construction, travel and tourism, and real estate finance sectors. Since its initial enactment in 2002, the Terrorism Risk Insurance Act (TRIA) has served as a vital public-private risk sharing mechanism, ensuring that private terrorism risk insurance coverage remains commercially available and that the U.S. economy could more swiftly recover in the event of a terrorist attack.

Catastrophic terrorism remains an uninsurable risk because its frequency and location cannot be accurately predicted, and its potential scale could be devastating. Without the backstop that TRIA provides, the private insurance market would be unable to provide adequate levels of terrorism risk insurance. TRIA continues to promote long-term availability of terrorism risk insurance for catastrophic terror events and provides a standard of stability for financial markets and recovery after such an attack.

In the absence of TRIA, the federal government would almost certainly be called upon to make significant expenditures after a large-scale attack on the United States. The Chamber strongly supports TRIA's current structure as it ensures the involvement of private sector capital from the outset while also protecting U.S. taxpayers. TRIA requires that individual insurance companies pay a deductible equivalent to one-fifth of their premiums for all TRIA-covered lines and then requires 15% copayment of all losses above their deductible, utilizing substantial private sector capital to pay losses from an attack before any involvement from the federal government. To further protect taxpayers, the program also mandates a recoupment mechanism to ensure that the federal government can be made whole after an attack.

While TRIA is currently set to expire at the end of 2014, the Chamber strongly urges Congress to reauthorize this program sooner rather than later. As the Chamber's member companies map out plans for the next ten months and beyond, the ability to secure terrorism risk insurance is crucial to ensuring that the American business community has the certainty that it needs to continue to move forward with projects and create jobs.

The Chamber thanks you again for holding this hearing and looks forward to working with the Committee to secure swift reauthorization of this important program.

Sincerely,

R. Bruce Josten

cc: Members of the Committee on Banking, Housing, & Urban Affairs www.naiop.org

NAIOP
COMMERCIAL REAL ESTATE DEVELOPMENT ASSOCIATION

February 25, 2014

The Honorable Tim Johnson
Chairman, Committee on Banking,
Housing and Urban Affairs
United States Senate
Washington, DC 20510

The Honorable Michael D. Crapo
Ranking Member, Committee on Banking,
Housing and Urban Affairs
United States Senate
Washington, DC 20510

Re: Committee Hearing Titled "Reauthorizing TRIA: The State of the Terrorism Risk Insurance Market, Part II"

Dear Chairman Johnson and Ranking Member Crapo:

NAIOP, the Commercial Real Estate Development Association, is the leading organization for developers, owners, investors and related professionals in office, industrial, retail and mixed-use real estate, and comprises 15,000 members and 47 local chapters throughout the United States. On behalf of our members, I want to commend you for holding this committee hearing to examine the state of the market for terrorism risk insurance, and the federal terrorism risk insurance program.

The federal program created under the Terrorism Risk Insurance Act of 2002 ("TRIA") after the attacks of 9/11 helped avoid economic dislocation and paralysis in our industry by providing a framework whereby the insurance industry could continue to offer terrorism risk insurance. Terrorism insurance is required by almost every lender for a developer to obtain credit. As a consequence, the continued availability of terrorism risk insurance is absolutely critical to the continued health of the commercial real estate industry. Unfortunately, while private insurance capacity for terrorism risk has improved, the reality is that private risk capacity remains constrained.

NAIOP
COMMERCIAL REAL ESTATE
DEVELOPMENT ASSOCIATION

As the policyholders and purchasers of insurance, our members in the commercial real estate development industry believe the TRIA program must be renewed to maintain the continued availability of terrorism risk insurance, and to prevent the unnecessary disruption of markets that are finally beginning to strengthen. This is not just a big city issue, but one that affects all communities throughout our nation where major commercial and industrial development occurs. We urge the Committee to act quickly to address renewal of the terrorism risk insurance program, and look forward to working with you on this effort.

Sincerely,

Thomas J. Bisacquino
President and CEO

NAPSLO

National Association of
Professional Surplus Lines
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Testimony of
the National Association of Professional Surplus Lines Offices

Before the
Senate Banking Committee
February 25, 2014

NAPSLO is the national trade association representing the surplus lines industry and the wholesale insurance distribution system. Since its formation in 1975, NAPSLO has become the authoritative voice of the surplus lines industry, advocating for the industry's vital role as a "safety valve" for hard-to-place and specialty insurance risks and for the industry's importance in the insurance marketplace and global economy. NAPSLO members also play an important role in creating new insurance products in response to the needs of an ever-changing social, business and insurance environment.

NAPSLO's membership consists of approximately 400 brokerage member firms, 100 company member firms and 200 associate member firms, all of whom operate over 1,500 offices representing approximately 15,000 to 20,000 individual brokers, insurance company professionals, underwriters and other insurance professionals in the 50 states and the District of Columbia. NAPSLO is unique in that both surplus lines brokers and surplus lines companies are full members of the association; thus NAPSLO represents and speaks for the surplus lines wholesale marketplace. We appreciate the opportunity to submit testimony to today's hearing.

NAPSLO commends the Committee for its continued focus on the Terrorism Risk Insurance Act (TRIA), particularly in light of its pending expiration at the end of 2014. In considering an extension of any program it is important to evaluate how the program has functioned and what aspects, specifically, are key to its success. NAPSLO believes TRIA has been successful primarily because it serves as a tool for insurers to better manage the risk of terrorism events and provides certainty to the industry in offering private capital and solutions to policyholders. Surplus lines insurers currently provide certain terrorism coverage pursuant to the mandatory provisions and subject to the deductibles and triggers of the existing federal program.

In general, we believe private market solutions should be exhausted before government-sponsored programs or residual markets are considered, and governments should not provide coverage options the private or open market is able to address. However, NAPSLO believes a role exists for the federal government in the management of terrorism risk, especially with respect to in the areas of workers' compensation and nuclear, biological, chemical or radiological exposures (NBCR). While insurers can model the severity of a hypothetical terrorist attack, it is impossible to model the likelihood or frequency of such attacks. As a result, we support a thoughtful and thorough review of TRIA with a goal of maintaining or increasing opportunities for capacity and solutions in the private market.

Many argue the deductibles and limits of the existing program and the lack of any triggering events has effectively already shifted terrorism risk to the private market. Under existing TRIA triggers and insurer liability caps, a significant terrorism event will have a material impact on the industry, and could cause financial impairment for certain smaller insurers. TRIA's caps on insurer liability provide some level of certainty and help insurers better manage the risk; increasing these caps would reduce the level of certainty in terrorism risk management, will place smaller insurers at greater risk, and may further limit the availability of private capital solutions for terrorism risks.

Another key consideration for the Committee is the timing on an extension to the program. While the program does not expire until the end of next year, it is important that Congress act quickly as insurers issue policies with coverage periods beyond 2014 and it is vital to have certainty with respect to the provisions of TRIA beyond its expiration date. Therefore, we thank the Committee and its leadership for its timely review of this program and would encourage its continued focus until an extension has been enacted.

Thank you again for the opportunity to comment on this important issue.

Testimony of Kean Driscoll

Chief Executive Officer

Validus Re

House Financial Services Subcommittee

on

Housing and Insurance

Hearing on

"The Future of Terrorism Insurance:

Fostering Private Market Innovation to Limit Taxpayer Exposure"

November 13, 2013

My name is Kean Driscoll and I am the Chief Executive Officer of Validus Re. I am pleased to appear before you today to provide my company's perspective on possible changes to the Terrorism Risk Insurance Program ("TRIP" or the "Program") that would incent more private market involvement. I commend Chairman Neugebauer for holding this important hearing and welcome the opportunity to address the Subcommittee on Insurance, Housing, and Community Opportunity.

Validus Group ("Validus") is a leader in the global insurance and reinsurance markets, operating principally through Talbot Syndicate 1183 at Lloyd's of London, and Validus Re. Talbot has written direct and facultative terrorism business at Lloyd's for more than 12 years and it is now the largest writer of that business by income. Validus Re is one of the largest stand-alone property terrorism treaty coverage providers in the world, with an estimated 10% market share, and it evaluates business opportunities on approximately 90% of all direct and facultative terrorism business written throughout the world. Validus' guiding objective, through its operating subsidiaries, is to maximize its return on equity subject to prudent risk constraints on the amount of capital its exposes to any single loss event.

Background on Reinsurance

Reinsurance is commonly referred to as the insurance of insurance companies. The reinsurance market is global and plays an important role in maintaining the financial health of the insurance marketplace and ensuring the availability of property and casualty insurance in the United States. Reinsurance may be used by insurers for several reasons. One of the most common purposes is to transfer risk from the primary insurer for catastrophic events, including hurricanes, earthquakes, and conventional acts of terrorism. Reinsurers have responded financially to virtually every major U.S. catastrophe over the past century. By way of example, 60% of the losses related to the events of September 11th were absorbed by the global reinsurance industry, and in 2005, 61% of Hurricanes Katrina, Rita and Wilma losses were ultimately borne by reinsurers.

Background of the Terrorism Risk Insurance Program

TRIP was enacted in response to the September 11, 2001 terrorist attacks, which forced all Americans to confront the previously unforeseen realities associated with a catastrophic terrorist attack on U.S. soil. Although the insurance and reinsurance industry responded in an unwavering manner, the events changed the way the industry views the terrorism risk.

TRIP was created to provide a federal backstop, which allowed the insurance industry to provide terrorism coverage to U.S. businesses. By limiting insurers' exposure to catastrophic terrorism losses, TRIP improved the private market for such coverage. The reinsurance industry strongly supported adoption of the Terrorism Risk Insurance Act in 2002, the 2005 Terrorism Risk Insurance Extension Act (TRIEA) and the 2007 Terrorism Risk Insurance Program Reauthorization Act (TRIPRA).

Reinsurers' Role Under TRIP

TRIP provides a large amount of reinsurance-like protection for commercial insurance exposures. Individual insurers retain a significant amount of terrorism risk losses through both a company deductible and a co-pay requirement for losses above the retention before TRIP funding is available. The insurance industry has significant financial risk and exposure to acts of terrorism because of the significant retentions under TRIP, the mandatory offer of coverage required under TRIP, state regulatory action related to rates and exclusions, and rating agency scrutiny.

Insurers may seek reinsurance from the private market to reduce the conventional terrorism exposure they face for potential losses between the deductible and loss-sharing provisions of TRIP. A reinsurer's ability to provide this coverage is limited by the amount of conventional terrorism risk it is willing and able to supply based on the amount of capital it allocates to terrorism coverage and its own specific risk evaluation. Because reinsurers are not covered by TRIP, reinsurers view TRIP in the context of the benefits provided to the broader industry as a whole.

The Current Reinsurance Market

Since 2001, insurers and reinsurers have worked hard to develop a better understanding of conventional terrorism risk. Reinsurers have created task forces, consulted military and intelligence experts, hired specialty risk modeling firms, invested in research and development, and implemented new underwriting standards all with the intention of offering private market solutions for the transfer of conventional terrorism risk. Conventional terrorism can be modeled, priced, and managed on a portfolio basis. The probability or frequency of an event can be estimated, albeit with less certainty than risk classes with a more robust historical record; however, the insurance and reinsurance industries have pioneered risk transfer solutions for many other classes of business that suffer the same shortcomings. To supplement the lack of a rich data set on frequency, we use open source intelligence that helps us estimate both the intent and capability of terror threat agents. This information is consolidated into an event set that helps us estimate the probability of various attack types at different targets.

Once we have established a perspective on frequency, we use well established modeling techniques to quantify hazard severity, vulnerability and financial loss. There is very good data on damageability from various blast sizes with secondary effects.

The question is not whether conventional terrorism risk can be priced, but rather, the precision of the parameters in a pricing model. We can and do currently price conventional terrorism risk, and estimate that approximately $7-8 billion of reinsurance coverage is purchased annually on a stand-alone basis for conventional U.S. terrorism. This excludes coverage that is included as part of general property/casualty, worker's compensation and other specialty lines coverages. We believe presently there is adequate reinsurance capacity to cover the insurance industry's current $27.5 billion retention under TRIP, and if the industry retention for conventional terrorism exposure grew over time, so to would the capacity of the reinsurance industry for conventional terrorism risk.

TRIP Renewal

TRIP is valuable to the insurance industry in underwriting conventional terrorism risk but it takes a "one size fits all" approach that could be modified to encourage more private market insurance and reinsurance participation. If the Committee is inclined to make changes to the Program, Validus encourages you to tailor the Program in accordance with the following comments.

1. The Program should continue to cover catastrophic terrorism loss scenarios related to nuclear, biological, chemical and radiological ("NBCR") attacks. The broader industry cannot effectively address these perils as the breadth of potential events is either unknowable or could potentially bankrupt the industry.

2. Cyber terrorism, a peril distinct from cyber liability, should be clearly covered by the Program. The scope, duration, potential damage and economic losses from this risk are also unknowable, and therefore, uninsurable.

3. The Program should clarify the process for certifying a terrorism event, including a defined time for making the certification

4. Validus has the ability and willingness to assume more conventional terrorism risk exposure, and I believe the reinsurance industry also has the ability and willingness to meaningfully expand its capacity for conventional terrorism risk. To reflect the fact that the industry's appetite for writing conventional terrorism risk has grown since the last extension, the Program could be modified through a variety of ways, including:

    a. Gradually increasing the insurance industry retention and the size of a qualifying terrorism loss under the Program. This reduces the likelihood of having to fund a loss through taxpayer funds and it avoids short-term price and capacity dislocation in the broader industry.

    b. An expansion of the co-participation which would better align the insurance industry with the Program.

5. The insurance industry is a critical facilitator of effective risk management in virtually every industry, and every facet of life. Risky behavior, or highly exposed assets typically result in a higher premium charge. Policyholders can reduce higher premiums through effective risk mitigation techniques. Currently, the Program impedes the ability of the insurance industry to properly price its products, by shifting the risk of a conventional terror attack from the policyholder to the taxpayer. The improper allocation of a risk premium facilitates unintended outcomes. We see this phenomenon playing out in the flood market, as the heavily subsidized National Flood Insurance Program ("NFIP") has produced significant deficits. Congress should encourage a greater private sector risk bearing role and appropriate risk pricing. Insureds and insurers will then have an incentive to mitigate risk and price it

appropriately, and Congress can focus on genuinely becoming a "reinsurer" of last resort for conventional terrorism risk.

6. Finally, special consideration should be made for smaller insurers, as well as for the insurance industry generally with respect to workers compensation exposure accumulations in metropolitan areas, which could be disproportionately impacted in the near term by any of the changes to the Program.

Thank you for the opportunity to testify. We look forward to continuing this dialogue as the renewal process moves forward.

Swiss Re

Donald Preston, Jr.
Senior Vice President
Head Governmental Affairs Americas

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U.S. Senate Committee on Banking,
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February 24, 2014

Statement for the Record, Senate Banking Committee Hearing, "Reauthorizing TRIA: The State of the Terrorism Risk Insurance Market, Part II"

Chairman Johnson and Ranking Member Crapo,

We appreciate the opportunity to submit this statement for the record as part of the important hearing the Committee is holding on the reauthorization of the TRIA program. The statement includes the testimony of Swiss Re Americas CEO Eric Smith before the House Financial Services Committee on September 19, 2013. The dates and references to time included in the testimony reflect the time period during which the testimony was originally given. However, the underpinnings of the testimony remain the same in present day. Swiss Re supports a long-term, clean reauthorization of the TRIA program. We believe the current program both protects taxpayers and serves policyholders by facilitating a market for terrorism insurance.

We applaud the Committee for addressing this important issue in a timely manner. We look forward to working with you and your staff on this issue and are happy to address any questions you may have regarding this submission.

Yours sincerely,

Donald G. Preston Jr.

SWISS RE
150
YEARS

UNITED STATES HOUSE OF REPRESENTATIVES

COMMITTEE ON FINANCIAL SERVICES

SEPTEMBER 19, 2013

"THE TERRORISM RISK INSURANCE ACT of 2002"

J. ERIC SMITH

PRESIDENT AND CHIEF EXECUTIVE OFFICER

SWISS RE AMERICAS

UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES

SEPTEMBER 19, 2013
"THE TERRORISM RISK INSURANCE ACT of 2002"

J. ERIC SMITH, PRESIDENT AND CHIEF EXECUTIVE OFFICER
SWISS RE AMERICAS

Chairman Hensarling, Ranking Member Waters, and members of the Financial Services Committee, my name is Eric Smith, and I am president and CEO of Swiss Re Americas. On behalf of Swiss Re, I thank you for the opportunity to testify this morning on the state of the terrorism risk insurance marketplace and the important role the Terrorism Risk Insurance Act (TRIA) plays in providing market stability and certainty, and ensuring an orderly economic recovery following catastrophic terrorism in the United States. Swiss Re is a global reinsurance company with a highly-skilled workforce of several thousand employees in more than thirty offices throughout the U.S., and we transact U.S. business through U.S. companies, including primary insurance companies that are subject to TRIA.

Swiss Re recently published a paper, *Terrorism Risk Insurance Act: The Economic Case for Public-Private Partnership*, that covers in detail many of the topics in this statement. It is attached for your review.

As the CEO of a company with dual marketplace roles as a global reinsurer and an insurer offering coverage for terrorism risk, I believe that I can offer the Committee a unique perspective on three critical issues:

1. Why the risk of terrorism continues to be uninsurable;
2. How both the traditional and non-traditional reinsurance markets view the risk of terrorism; and
3. How other governments manage terrorism risk insurance compared to the United States.

In focusing on these three issues, I hope to reinforce for this Committee the critical role that TRIA has played in supporting the management of terrorism risk exposure by the private market and stabilizing the U.S. economy since its initial enactment in 2002. I also hope to clarify the impact of the recently reported influx of capital into the catastrophe bond market and what, if any, role this capital has in supporting the terrorism reinsurance market. Last week, Swiss Re submitted comments to the Federal Insurance Office for their report on the long term availability and affordability of insurance for terrorism risks. In those comments, we reach a conclusion that bears repeating to this Committee today: unlike most natural catastrophes, major acts of terrorism remain uninsurable by private markets, and the extension of TRIA is vital for the stability of the U.S. insurance industry.

Summary of TRIA as Public-Private Partnership

Just over 12 years ago, in the wake of the devastating September 11 attack, the re/insurance industries responded to unprecedented levels of terrorism loss by helping our policyholders, and the economy, recover. The total insured loss of $32.5 billion ($42.1 billion in 2012 dollars) was the largest terrorism loss on record and remains many multiples of any other terrorist attack loss.[1] After the 9/11 attack, the industry recognized that the peril of terrorism had changed forever, with the prospect of truly catastrophic terror events being carried out by well-organized, and well-funded, terrorist groups. Terrorism was a new form of warfare carried out in the shadows and was not a peril that was viewed as "insurable" in the traditional sense of the word.

As a result, the insurance industry worked with the federal government in evaluating a number of different proposals for creating a public-private partnership for financing terrorism risk. Ultimately, the federal government passed TRIA in late 2002, providing a loss sharing partnership between the federal government and commercial property-casualty insurers, while making terrorism coverage available to all U.S. businesses. The passage of TRIA solidified the economy and reinforced the resiliency of the markets against future terrorist attacks. Subsequent extensions of TRIA have maintained the public-private partnership, providing stability that has enabled insurers to manage their individual terrorism exposures to the extent possible, while ensuring that the federal government remains a backstop for large-scale terrorism as well as a necessary post-hoc redistribution channel.

Terrorism Remains an Uninsurable Risk

Swiss Re is celebrating its 150th anniversary this year. Terrorism has been around since our company began operations, as have natural catastrophes. Yet re/insurance for natural catastrophes is much more available and much more affordable than coverage for terrorism Why is this the case? The answer is straightforward: even with all our years of underwriting experience, we do not believe that we understand terrorism risk in the same way that we understand natural catastrophe risk.

Almost 11 years after TRIA's enactment, the industry's knowledge of terrorism has evolved. We have made great strides in exposure management and in understanding the potential severity of different conventional terrorism attack scenarios. Unfortunately, the one aspect of terrorism that has not changed is that, absent a federal government role in managing terrorism exposure and loss, the risk is ***not*** privately insurable. For the private insurance marketplace to function with respect to a risk, it must be measurable, have loss occurrences that are largely independent, have manageable average and maximum losses, and be mutually acceptable to both the insured and the insurer. Terrorism risk fails each of these conditions.

Despite the best efforts of modelers, terrorism risk remains unmeasurable today, largely because of the ***intentional nature*** of a terrorist attack. In the case of natural catastrophes, events represent random, uncorrelated outcomes from underlying physical processes or

[1] Hartwig, Robert P and Claire Wilkinson, "Terrorism Risk: A Constant Threat: Impacts for Property/Casualty Insurers," Insurance Information Institute, June 2013.

phenomena. As such, through the efforts of geologists, engineers, and meteorologists, insurer's understanding of the risk of natural disasters has improved and a steadily growing

body of data exists for the development of catastrophe models for natural disasters. While the data may still exhibit uncertainty, insurers can manage to this uncertainty. In contrast, for terrorism, the terrorist actually tries to confound those who study them – effectively invalidating any sample used to estimate their behavior. As such, even the most skilled practitioners are far from an informed consensus regarding how to accurately model terrorism risk. The models that do exist have not been tested, so we don't have the same level of confidence in terrorism models that we would have in models for other types of perils, where we have much more information that has permitted us to test the waters. There simply is no effective basis for assessing the likelihood, location or type of a terrorist attack.

Moreover, the risk of terrorism is ***dynamic*** and ***interdependent***. The goal of a terrorist is to avoid detection and inflict the maximum loss possible at precisely the weakest link in our economy. Since terrorists modify their tactics in the face of any known defensive strategies or loss mitigation, their methods and targets are constantly changing. This constantly changing threat dynamic places a premium on the secrecy of the government's intelligence information and effective countermeasures. Keeping this information confidential is vital to the efficacy of the government's interdiction efforts, but it undermines attempts to measure the risk of terrorism in the private sector – an acceptable trade-off to limit the overall likelihood of an attack.

At the same time, terrorism losses have the potential to be truly ***catastrophic in size and scope,*** impacting a wide array of different policies and policyholders, as well as impacting the overall financial markets and economy. This extreme correlation is another classic example of a failure of private "insurability." The loss potential from a successful terrorist attack using unconventional means such as nuclear, biological, chemical, or radiological weapons can measure in the hundreds of billions of dollars and be well in excess of the maximum loss potential for natural catastrophe events in the United States. With at most an estimated $200b in surplus backing all of the different sources of risk to TRIA-eligible lines of business, the insurance industry simply does not have the capital, absent TRIA, to absorb this level of loss.

In fact, no private capitalization strategy for unconventional terrorism makes economic sense. If re/insurers were asked to hold a sufficient level of capital to withstand these cataclysmic losses – maybe to maintain ratings for writing other lines of business -- the price of terrorism insurance would have to be so high as to make it uneconomic for the policyholder. The net result is that the market for terrorism would violate the ***mutuality*** principle requiring the transfer of risk to be mutually beneficial for all members of the risk pool. Suggestions to the contrary and proposals to cross-subsidize the provision of terrorism insurance with surplus backing other lines of business demonstrate a failure to understand terrorism risk, the private insurance mechanism and business model, the process for establishing risk-based premiums, and the parameters of state insurance law. Simply put, a public-private structure for pooling catastrophic terrorism losses is necessary.

Traditional Reinsurance Capacity

As Swiss Re is a leading global reinsurance company, I also want to comment on the capacity of the reinsurance market and the potential real and illusory opportunities for growth in the terrorism reinsurance market. Recognizing the same challenges of insurability that face primary insurance companies, the reinsurance market has dedicated very limited capacity to

support the provision of terrorism reinsurance. The capacity we do offer supports our clients and the mandates that they must adhere to under TRIA. Based on the most recent estimate, the total amount of reinsurance capacity available for terrorism in the United States is approximately $6-10b – well below the $27.5b insurance marketplace aggregate retention under TRIA and the $34-35b cumulative insurer loss retentions. As a point of reference, the total global capacity for natural catastrophe risks has been estimated as $300-$350 billion, with the U.S. commanding roughly 35-45% of this capacity.

Moreover, the reinsurance capacity that is available for terrorism in the U.S. generally is limited to conventional terrorism losses, with virtually no capacity available for unconventional NBCR terrorism. Even for conventional terrorism, terrorism reinsurance may be further constrained within large metropolitan areas due to exposure aggregation challenges. Thus, while private reinsurance is playing a role in helping to manage the risk of terrorism, the market for terrorism reinsurance is relatively small and operates within the existing TRIA retentions for large insurance companies.

With TRIA in place, private reinsurance companies have been able to make marginal increases in the amount of capacity provided for conventional terrorism losses – increasing from $4-6 billion several years ago to $6-10b today. This additional reinsurance capacity can be extremely valuable to primary insurers as they manage their considerable exposure within the existing TRIA retentions. The commitment that the federal government has provided to the terrorism insurance market through TRIA has given the reinsurance community the confidence in the market to offer this capacity. I don't envision a scenario where private reinsurers are competing against TRIA for providing reinsurance against extremely large or unconventional terrorism losses. Simply put, the existence of TRIA supports the ability of the reinsurance markets to providing capacity for our clients to manage terrorism losses within the aggregate industry retention. If TRIA were permitted to expire, that capacity would no longer be available.

Capital Markets and Insurance-linked Securities

I would also like to take a moment to comment on the recent influx of capital into the insurance-linked securities (ILS), or catastrophe bond, markets, as Swiss Re is a market leader in providing this alternative risk management solution. Spurred by the quest for higher yields in a persistent low interest rate environment, many pension funds and asset managers have created or expanded their mandates to invest in insurance-linked securities (ILS). As a result, Swiss Re estimates that total alternative reinsurance capacity – including catastrophe bonds, sidecars and other non-traditional financing vehicles – has grown to approximately $40b worldwide – comparable to the levels reached immediately after hurricanes Katrina, Rita and Wilma in 2005.

The maturation of the ILS market over the past decade has been an exciting and welcome development. The ability of primary insurance and reinsurance companies to access new sources of capital to fund peak natural catastrophe exposures – the main recipient of these capital investments -- has helped keep capital costs down and traditional insurance more affordable. Moreover, the timing of the capital flows is fortuitous, especially with demand for natural catastrophe coverage expected to grow between 50% in mature markets to 200% in high growth markets, as population growth in high risk areas continues unabated.[2]

However, the ILS market does not substitute for traditional insurance and the ILS market has not been willing to underwrite risks that are not being underwritten by the traditional reinsurance market. Moreover, investors are reluctant to buy terrorism bonds for two reasons. First, there is a correlation between terrorism risk and the broader equity markets -- financial markets are more sensitive to terrorism risk and the possibility of broader economic disruption. Second, there is a greater potential for adverse selection – that is, those with the highest risks purchasing the coverage. Finally, rating agencies have been reluctant to rate terror bonds because of the inherent uncertainty in determining the risk, which further restricts potential investor interest. As a result, to date, there have been no securitizations of property catastrophe bonds solely for terrorism risk in the market despite this influx of capital.[3] With terrorism risk largely uninsurable, we may never see a significant market for terror bond securitizations.

TRIA in Comparison with Other Government Programs

Recognizing the private "uninsurability" of terrorism and the "public good" of protecting an economy from a terrorist attack, many other countries exposed to the risk of terrorism have created their own government mechanisms for financing terrorism losses. The terrorism program in each country is unique to that country's own political environment and perceived risk. The structures range from Israel's complete government insurance model to the public-private partnerships created in the United Kingdom ("Pool Re") and in Germany ("Extremus"). Contrary to other countries, the U.S. program does not collect up-front premiums. However, TRIA incorporates a significant recoupment mechanism for financing losses after an event and has comparatively high insurance company retentions – forcing the private sector to bear a larger portion of the risk.

Specifically, under TRIA, the federal government reimburses 85% of all losses in excess of individual insurance company "deductibles" up to an annual aggregate industry loss cap of $100b. Individual company deductibles are set at 20% of prior-year direct earned premium for TRIA-eligible lines. However, to ensure that the program provides industry protection -- not individual company protection – TRIA includes a mandatory recoupment provision that requires repayment via policy surcharge of any federal tax dollars used to reimburse terrorism

[2] Swiss Re presentation to investors and the media, p. 16, September 9, 2013 (http://media.swissre.com/documents/pres_20130909_Monte_Carlo_final.pdf)

[3] The FIFA event cancellation bond in 2006 and the Swiss Re excess mortality bond program included the peril of terrorism. Both were multi-event bonds, with the FIFA bond covering natural catastrophes and terrorism events, and the excess mortality program covering pandemic and terrorism. In both bonds, the terror component was deemed insignificant to the loss exposure of the investors.

losses up to an insurance marketplace aggregate loss retention of $27.5b. Moreover, program losses above the $27.5b can be funded through discretionary recoupment using the same surcharge mechanism.

In the event of a future terrorist attack, TRIA helps to speed the flow of payments to those affected businesses that have purchased terrorism insurance, as well as their employees, which helps those businesses and the economy recover. The clarity and commitment of an explicit federal backstop enhances the ability of re/insurers to offer terrorism insurance and helps the private market to ameliorate the potential loss from an attack. In addition, taxpayers benefit in many ways from TRIA. First, taxpayers benefit from the economic security provided by having access to commercial terrorism insurance before an attack. Second, after an attack, the immediate flow of claims payments offers stability to commercial taxpayers that suffer directly or indirectly from an attack and minimizes economic disruptions that would otherwise follow an attack. Finally, to the extent that federal resources are needed to respond to a truly catastrophic terrorism loss, TRIA's recoupment mechanism provides a stable way to ensure that federal expenditures ultimately can be recaptured and repaid without compromising the viability of the private commercial insurance marketplace.

Conclusion

At bottom, it is the unique and uninsurable characteristics of terrorism that are driving all of these developments. From Swiss Re's vantage point as a reinsurer and an insurer subject to TRIA, the nature of the risk underscores the need for a continuing government partnership with the private sector under TRIA. TRIA may not be perfect, but it has proven to be an effective way of balancing the challenges of terrorism risk with national security, private market stability, and establishing the foundation for an orderly economic recovery following catastrophic terrorist attacks on U.S. soil. Thank you again for inviting me to testify today, and I would be happy to answer any questions from the Committee at the appropriate time.

Swiss Re

Terrorism Risk Insurance Act (TRIA)

The Economic Case for Public-Private Partnership

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The Terrorism Risk Insurance Act (TRIA), a congressional act that has protected the US economy from terrorism since 2002, is set to expire in 2014. Unlike most natural catastrophes, major acts of terrorism remain uninsurable by private markets, and the extension of TRIA is vital for the stability of the US insurance industry. International comparisons with foreign government programs provide insight into the range of options.

Contents

I. Uninsurable features of terrorism risk

The mere existence of terrorism insurance...

At first glance, it might appear that terrorism risk is insurable. After all, it is a risk that insurers currently carry on their books and that reinsurers used to cover in the past, even without TRIA. Yet even though terrorism has been insured in competitive markets previously, it is not a fully insurable risk.

...does not prove that it would be widely available under free market conditions.

Although terrorism coverage is available for most insureds much of the time, it is not universally available under free market conditions. Because terrorism risk has many qualities that make it difficult to insure, insurers limit their exposure. The resulting limited supply of coverage means that, for some insureds, it will be either entirely unavailable or available at prices that are prohibitive.

Terrorism risk lacks many of the characteristics that would make it insurable.

Insurable risks are measurable, have independent loss occurrences, manageable average and maximum losses, premium rates that are acceptable to both insurer and insured, and adequate industry capacity.[1] Terrorism risk fails to meet these criteria. For terrorism, there is a lack of both historical data and simulation data. Existing data is mostly classified by intelligence agencies, and furthermore, any known attempts to de-classify and model such data in private markets could invite terrorists' deliberate attempts to evade prediction.

Information to quantify risk is not adequate for underwriting.

Terrorism risk is unmeasurable

Terrorism risk is impossible to measure precisely. It is inherently more challenging than natural catastrophe risk, because of the willful nature of terrorist attacks and historical data that is limited and largely irrelevant. Natural catastrophes are physical phenomena. Through the efforts of geologists, engineers and economists, insurers' understanding of these risks has improved over time. A steadily growing body of data on catastrophic events – and declining computation costs – have facilitated the development of more accurate catastrophe models.

[1] Swiss Re, sigma 4/2005, "Innovating to insure the uninsurable."

Due to the willful nature of terrorist events, modeling approaches remain unproven.

Terrorism risk cannot be assessed in the same way. Unlike a natural catastrophe, it is a willful act. Terrorists, unlike natural phenomena, try to confound those who study them. Although they have improved in the past five years, models that forecast the frequency and severity of terrorism events remain in their infancy. The models are highly subjective and idiosyncratic. Even the most skilled practitioners are far from an informed consensus on how to effectively model terrorism risk.

Insurers must exercise great caution when promising to cover ambiguous risks.

Because the probabilities underlying terrorism risk are poorly understood, insurers exercise great caution when covering the risk. One study found that underwriters require premiums 43% to 77% higher in cases of extreme ambiguity than when the probability of a risk is clearly understood.[2] Lack of clarity with respect to terrorism risk makes insurers less able to cover it and prompts them to charge higher risk premiums.

Loss occurrences are not independent

Terrorism losses are correlated over time and across business lines.

Insurable risks are generally characterized by independent loss occurrences. In recent years, terrorists have shown a preference for launching coordinated attacks, which can make loss occurrences highly correlated. As the scale of terrorist attacks has escalated, their potential to affect many lines of business has grown. Results from terrorism coverage can therefore be highly correlated across lines of business.

Average and maximum losses unacceptably high

Insurable risks are of a magnitude that insurers can bear.

Insurable risks tend to occur with a regular frequency that allows the industry to plan for average and maximum losses. For unprecedented events, insurers do not have enough data to accurately estimate risk or hold adequate reserves to cover probable maximum losses. A large-scale terrorist attack could generate potential losses so far beyond the scope of other insured risks that they cannot be diversified within the private insurance industry. Loss estimates for terrorism scenarios must consider the worst-case total loss exposure. Many industry participants learned on 11 September 2001 that their scenarios were not, in fact, "worst case".

Terrorism losses, by contrast, can be truly devastating.

Potential losses are limited only by the imagination of terrorists. An RMS study estimates that a release of anthrax in Chicago could cause $55 billion in insured workers compensation and life/health losses. Towers Perrin found that a New York City release of anthrax could cause $91 billion in insured workers compensation losses. Other scenarios that include weapons of mass destruction lead to insured losses in excess of $250 billion, nearly equal to the total claims paying capacity of the entire US commercial property and casualty sector. Finally, a recent study by the American Academy of Actuaries indicates a potential for $778 billion of insured losses from a large CNBR (chemical, nuclear, biological or radioactive) attack on New York City. Although these studies address CNBR events, recently-thwarted terrorist plots demonstrate that conventional items can also cause mass destruction.

Mutuality

For a risk to be insurable, there must be *mutuality*, a communal willingness to share the risk.

One further characteristic common to insurable risks is *mutuality*, which implies that the parties exposed to a given risk are willing to join together to build a risk community to share the risk. Insureds must be satisfied that the terms of the risk

[2] Howard C. Kunreuther et al, "Ambiguity and underwriter decision processes", *Journal of Economic Behavior and Organization*, May 1995.

sharing with other members of the risk community are economically fair, a perception that depends on society and culture.

Without mutuality, adverse selection occurs, increasing the chance of market failure.

If only high-risk parties are willing to purchase insurance (so-called "adverse selection"), coverage may become unaffordable as premiums rise to reflect the risk profile of the adversely-selected insureds. This problem of adverse selection further increases the likelihood of market failure.[3]

A lack of mutuality makes it difficult to buy terrorism coverage in major urban areas.

This represents a basic market failure that policy makers should work to rectify.

Just such a lack of mutuality appears to exist in major urban areas, which are at greatest risk of terrorist attacks. New York City, Los Angeles, Toronto, Chicago, Washington D.C., and Boston are not mere exceptions. Aside from their great symbolic and economic importance, these metropolitan areas are home to approximately 60 million people. In such high profile cities, businesses and individuals are much more likely to purchase terrorism insurance, while those in less densely-populated areas are not, resulting in adverse selection and market failure that affects about 20% of the population of the US and Canada.

II. Market imperfections and the need for intervention

Free markets, though often highly efficient, are sometimes wasteful.

Although competitive private markets generally lead to the most productive allocation of resources, markets sometimes fail to function efficiently, creating a waste of resources and loss of economic value. The market for terrorism (re)insurance is especially prone to market failure. When market failure occurs, the government can improve social well-being through appropriate intervention. This intervention can occur through the price mechanism (taxes, subsidies); by mandating provision of service; by public provision of service; by public financing of private provision; or through regulation.

Markets failures relevant to terrorism insurance

The malfunctioning of markets, which economists call "market failure"...

There are three fundamental economic reasons why government intervention in the market for terrorism insurance market will benefit the country.

- imperfect information
- the private sector's underproduction of, or failure to produce, *public goods*
- *externalities* that may not be taken into account

Imperfect information

...often arises from imperfect information.

Information imperfections are a basic source of market failure. Producers and consumers must have adequate knowledge of product quality and prices to make sound economic choices. The absence of sufficient information can reduce market activity because of distrust between buyers and sellers.

Information imperfections are endemic to the insurance industry ...

The problem of imperfect information is often the central challenge facing insurance buyers and sellers. Insurance contracts promise future delivery and rely on *pricing inversion*, i.e., the price is set before the costs of production (claims and expenses) are known. Insurers and their insureds both face uncertainty with respect to these costs.

...particularly when there is adverse selection or a lack of opportunity to diversify.

When this uncertainty is especially pronounced due, for example, to changes in the legal, judicial or social landscape, markets become suboptimal. Insurers will not provide every type of coverage for which demand exists. In particular, they will

[3] Market failure can be rectified if coverage is made mandatory, solving the problem of adverse selection. Private insurer premiums would be lower, reflecting the risk profile of the entire risk pool, rather than that of just those in high risk areas. Mandatory and enforced risk based pricing can create a system that the public deems equitable.

avoid risks characterized by heightened adverse selection, basic ambiguity, or a lack of diversification opportunities. For example, private companies offer little unemployment insurance.

A government backstop can rectify this source of market failure for terror insurance.

Due to the imperfect information problems noted above — a shortage of historical data, a limited ability to model future events, and the willful nature of the risk — terrorism is a risk whose great ambiguity makes it prone to market failure. The provision of a government backstop injects much-needed certainty into the market, making it economically possible for the insurance industry to provide adequate coverage.

Public good

A public good is one that all enjoy in common.

A public good is one that "...all enjoy in common in the sense that each individual's consumption of such a good leads to no subtractions from any other individual's consumption of that good".[4] Examples of public goods include national defense, law enforcement (including the system of property rights), public fireworks, clean air and street lamps.

Public goods are underproduced because "free riders" can enjoy them without paying.

The ability of "free riders" to enjoy public goods without paying for them makes it less profitable for businesses to produce them. Even when society's collective willingness to pay for these goods exceeds their cost of production, individuals may be unwilling to pay a price high enough to warrant their production. Businesses will therefore tend to produce fewer of these goods than are socially optimal, or none at all. The tendency of businesses to underproduce public goods sometimes makes it beneficial for the federal government to provide these goods and services at an efficient level.

Counter-terrorism initiatives and the ability to insure against terrorism risk are public goods.

Government counter-terrorism policies and crisis management following an attack mitigate the risks associated with global terrorism. These initiatives, a natural extension of the government's role in national defense and law enforcement, provide a public good. The presence of a terrorism insurance market with enough capacity to meet the needs of the economy is likewise a public good, reducing the level of uncertainty both before and after a terrorist event. Security, stability, respect for property rights and the absence of violence and coercion are among the cornerstones of any society.

Externalities

Externalities arise when parties affect one another yet don't take this into account.

Externalities arise when the actions of one party make another worse or better off, yet the first party neither bears the costs nor receives the benefits of his effect on others. Externalities can be positive (e.g. creating beautiful architecture) or negative (e.g. blasting loud music). Markets provide incentives to maximize profits and minimize costs, but not to consider the profits or costs of others. Consequently, when externalities exist, producers and consumers lack incentives to consider the costs they impose, or the benefits they provide, to other parties.

A major attack would create negative externalities, disrupting the economy.

A major terrorist attack might easily result in externalities, with cascading losses. For example, the 2005 London Underground bombing cost an estimated $1 billion in lost tourism and transport revenues. One study finds that, absent TRIA,

[4] Paul A. Samuelson (1954), "The pure theory of public expenditure", *Review of Economics and Statistics*, 36 (4): 387-389. The opposite of a public good is a private good. Water, for example, is a private good: its owner can exclude others from using it, and once it has been consumed, it cannot be used again.

coordinated truck bomb attacks in the US could cause the loss of more than a million jobs and a decline in real GDP, due to sharp declines in confidence and investment. With TRIA in place to improve economic confidence and recovery time, the number of jobs lost would be reduced by half and the GDP decline averted.[5] Furthermore, the non-renewal of TRIA could have negative externalities of market uncertainty, so that even without another major terrorist attack, the absence of TRIA would cause US GDP to decline by 0.4% and cut employment by 326,000 jobs.[6]

III. Insufficient industry capacity to cover a massive terrorist event

Total industry capital is not a good indicator of terrorism insurance capacity.

Despite the insurance industry's size, total capital is not a good indicator of the amount that would be available to cover losses from terrorism. Based on aggregate data, the industry appears to have ample resources to cover large-scale terror events, as US property/casualty firms had a total surplus of $615 billion and wrote $522 billion in total direct premiums in 2012.

Surplus appears high due to natural catastrophes, low interest rates, and regulatory requirements, but would not be available for terrorism.

However, industry surplus appears high compared to historical levels for three main reasons. First, other catastrophe risks, such as major hurricanes, create the potential for large and increasingly-frequent losses. Industry surplus has grown to provide coverage for natural catastrophes, as these risks have grown over time, due to both weather patterns and property value concentration in coastal areas. Second, surplus currently appears inflated due to historically-low interest rates. Third, regulatory requirements have changed since the financial crisis, and insurance companies have a fiduciary responsibility to shareholders to employ capital responsibly. Therefore, insurers and reinsurers must continually adjust surplus to adhere to both regulatory and financial risk management standards. These factors are subject to change surplus quickly (for example, in the event of a major hurricane or a rise in interest rates) and do not guarantee that surplus would be available for terrorism risk in the future.

Surplus is also segmented by line of business and geography.

Furthermore, the aggregate industry surplus is compartmentalized by line of business, and most annual premiums are needed to pay claims for high-frequency losses such as motor insurance. Also, the aggregate surplus represents funds held by insurers writing coverage in all states. For example, if a major terrorism event occurred in New York, Washington or Los Angeles, only insurers writing policies in the state where the attack occurred would be liable.

An increase in reserves would help, but would cause accounting and regulatory problems.

One possible response is for the industry to build reserves. But insurers lack incentives to hold expensive equity capital sufficient to finance losses from extremely high severity, low frequency events. US accounting provisions preclude establishing pre-tax terrorism reserves. Even if they were allowed to do so, tax law would penalize such reserving via double-taxation of the investment income earned on reserves, which would substantially reduce after-tax profitability. In

[5] Economy.com, "The impact of terrorist attacks on the US economy", Report for The Hartford, October 2005.
[6] "Economic Effects of Federal Participation in Terrorism Risk," American Insurance Association, 2004

addition, some argue that high reserves would invite regulatory scrutiny and consumer backlash in the event of a rate increase.[7]

According to research, massive Florida windstorm losses could destabilize the industry.

Massive losses could potentially destabilize the insurance industry. Research on the effects that a $100 billion Florida catastrophe would have had in the late 1990s offers some clues.[8] Although the industry would have been able to pay 90% of the losses, approximately 140 insurers would have failed, the largest failure rate in more than a century. Post-event, there would be fewer insurers and those that would remain would raise rates, tighten terms and conditions and, in many cases, withdraw coverage completely.

Yet the industry is even more vulnerable to terrorist events.

The insurance industry is more vulnerable to terrorist events than to natural catastrophes. Whereas windstorm risk is insured and backed by state funds and global reinsurers, terrorism risk is a smaller market, backed just by TRIA and a limited amount of reinsurance.

IV. Securitization not a viable substitute for terrorism insurance

Over the past decade, a market for Insurance Linked Securities (ILS) has developed for modeled risks.

The maturation of a market for Insurance Linked Securities (ILS) over the past decade has been an exciting development but does not substitute for traditional insurance. Risk assessment for catastrophe bonds is not done by expert underwriters but by risk rating agencies on behalf of investors. While catastrophe bonds can increase capacity and access for different investor pools, they cannot push the boundaries of parametric uncertainty or ambiguity. Catastrophe bonds therefore focus on the best understood and modeled risks. Thus far, capital markets have not assumed insurance risks that would not be assumed traditionally by reinsurers. Because terrorism risk is largely uninsurable, a significant market for terrorism bonds may never develop.

A pure terrorism bond is not yet feasible.

A pure terrorism bond would require rating agency evaluation and would need to overcome investor resistance. To rate terrorism bonds, ratings agencies would need to rely on third party terrorism risk models. These have not yet proven trustworthy to the investment community. Even with a rating, investors would be reluctant to buy terrorism bonds, due to the potential for moral hazard and asymmetric information. Since investors feel most comfortable with risks that insurers underwrite, terrorism bonds could supplement, but not replace, insurance.

The $14 billion capacity of cat securities in 2012 is dwarfed by the $28 trillion value of private and residential structures.

Catastrophe bonds, the most mature segment of the ILS market, are created mostly for natural catastrophes. After a decline in issuance following 2007, total issuance has grown since 2008 and reached approximately $6 billion in 2012, bringing total capacity to approximately $16.5 billion at year end 2012. This amount is dwarfed, however, by the value of private property in the US. The aggregate value of U.S. private nonresidential structures, including office, industrial, and retail properties, is about $11 *trillion*, according to the U.S. Commerce Department's Bureau of Economic Analysis. The total value of residential structures in the US is

[7] Dwight M. Jaffee and Thomas Russell, "Catastrophe insurance, capital markets, and uninsurable risks", *Journal of Risk and Insurance*, June 1997.
[8] David Cummins et al, "Can insurers pay for the 'big one'? Measuring the capacity of the insurance market to respond to catastrophic losses", *Journal of Banking and Finance*, March 2002, pp. 557-583.

estimated at $17 *trillion*. Thus, the total insurance-linked securities market still provides only a small fraction of the potential capacity needed.

Terrorism risk will likely represent a small share of overall ILS issuance in coming years.

Only two types of terrorism-related bond have been issued to date, and neither is explicitly a terrorism bond. Rather, each is a multi-event cat bond associated with the risk of terrorist attack or the risk of natural disaster or pandemic. The first bond was developed by FIFA, the world football governing body, to protect its investment in organizing the 2006 World Cup in Germany. The security, rated investment grade (A3) by Moody's, covered natural and terrorist catastrophic events that would result in the cancellation of the World Cup game. The second category of bonds related to terrorism is catastrophic mortality transactions, which cover significant increases in population mortality for any reason. Rating agencies and investors have become comfortable with these transactions, because the main source of risk is a pandemic or natural catastrophe with higher expected value than a terrorist attack, so that terrorism risk contributes only a small portion of the expected loss. Currently, there is no expectation that pure terrorism bonds will be offered in the catastrophe bond market.

V. Advantages of a public-private response to terrorism risk

Even without a backstop, the government would likely step in after a major terrorist attack.

Without TRIA, the Federal government would lack an explicit backstop for major terrorist attacks. Many believe that the government would nonetheless provide aid to individuals, insurers, and other businesses who suffer devastating losses from a terrorist event, even if they have not purchased insurance. Thus, even without an explicit terrorism risk backstop, the government provides a perceived implicit backstop. However, such uncertainty about whether the government would step in distorts incentives for the private market and increases the likelihood of misspending funds.

This implicit backstop distorts incentives and increases waste.

An explicit government backstop offers numerous advantages...

An explicit government terrorism risk backstop offers numerous advantages. It reduces ambiguity both pre- and post-event and enhances transparency by making it clear who will pay how much for what, should an event occur. This clarity makes it easier for insurers to price risks and strengthens the incentives to mitigate risks and to purchase terrorism insurance.

...making lower premiums and higher coverage possible.

A broader societal sharing of terrorism risk makes lower premium rates possible. The median premium rate for terrorism insurance for middle-size and large firms was $57 per million of total insured value (0.0057%) in 2004, $37 per million (0.0037%) in 2008, $25 per million (0.0025%) in 2009, according to Marsh. By 2012, medium rates for the largest companies (those with greater than $1 billion total insured value) declined to $19 per million (0.0019%). The decrease and stabilization of premium rates is largely explained by the absence of any new attack on U.S. soil, as well as the effect of competition in insurance markets. By reducing uncertainty, a backstop also reduces the risk of financial market disruption in the wake of an attack.

By lowering the disruptive impact of terrorists, a government backstop reduces their incentive to strike.

A final benefit of an explicit backstop is that it reduces the "gains to terrorism". A goal of terrorists is to undermine a society through confusion and fear. A backstop that provides contingent resources reduces the cost of disruptions and the gains to terrorist acts. The prospect of a smaller "payoff" may conceivably reduce the incentive for terrorists to act, allowing insurance to discourage terrorism.

Appendix: International comparisons

Most countries facing terrorism risk already have government programs either proposed or in place.

Most countries facing terrorism risk have programs initiated or proposed by their governments to backstop terrorism risk, including European countries (Austria, Belgium, Denmark, France, Germany, Italy, Netherlands, Northern Ireland, Spain, Switzerland, UK), as well as countries in other regions (Australia, Hong Kong, India, Israel, Russia, Sri Lanka, Taiwan, Namibia, South Africa). Some developing countries also face substantial terrorism risk but do not have governance systems in place to address the risk.

Such programs usually develop after a large terrorism event...

Each country has developed a terrorism insurance arrangement unique to its own political structure and perceived level of risk, usually established following the experience of a major terrorist attack. The overview below shows the variety of approaches taken by different countries to terrorism risk sharing between the government and the private insurance industry.

...therefore reflecting each country's unique political and historical situation.

On one end of the spectrum, Israel has faced high costs of terrorism historically, using complete government coverage and no private involvement. On the other end, Germany has established a private insurance company dedicated to extreme risk. Other countries, such as Spain, France, UK, and US, have developed different structures for public-private risk sharing, using pre-determined loss tiers.

On the international spectrum, the US program reflects a middle ground of public and private involvement.

Contrary to what is done in some other countries, the U.S. federal government does not collect any premiums in exchange for covering 85% of the insurer's losses above the deductible. However, compared to other countries, private insurers in the US must pay a high deductible before triggering any government assistance, and this deductible has increased over time.

1. Israel: Complete Government Coverage, No Private Involvement

Israel relies completely on government.

Since 1961, any direct or indirect damages from terrorist attacks within Israel, for either individuals or businesses, have been compensated directly by the State's public compensation fund according to a pre-defined formula. The public fund is financed by the general property tax collected across the country, and there is no private insurance for terrorism risk.

2. Spain: Government Coverage, Sold by Private Insurers

Spain provides state-backed catastrophe reinsurance in exchange for premiums.

Since 1954, terrorism has been covered as part of the State-backed insurance compensation for extraordinary risks, which also includes natural hazards and riots, from the *Consortio de Compensation de Seguros* fund. Private insurers sell property insurance including terrorism coverage as an add-on, but private insurers do not bear any catastrophe risk. Commercial enterprises pay a fee of 0.21 euros per thousand of property coverage and an additional 0.25 euros for business interruption insurance against catastrophic risks, with no differentiation in rates. The fund has over 4 Billion euros in reserves, and during its 50-year history, it has been able to pay claims quickly without requiring additional government backstop.

3. France: Public-Private Risk Share, Unlimited Government Reinsurance

The French government backs a reinsurance pool...

Since December 2001, the public-private partnership GAREAT has provided a co-reinsurance pool for sharing commercial terrorism risk, not including personal lines. The first layer of 400 million euros is shared between 105 members, pro-rated to their share of ceded business. The second layer up to 2 Billion euros is provided by private insurers and reinsurers. Beyond 2 Billion euros, the French government provides an unlimited guarantee through the state-owned reinsurance company

...made possible by mandatory universal coverage and uniform insurance premiums.

Caisse Centrale de Reassurance (CCR). Premiums are shared between the pool (52%), reinsurance (36%), and the CCR (12%) (Michel-Kerjan, 2012).

A key feature of the French system is that terrorism insurance is mandatory, so that the take-up rate is 100%. Reinsurance rates do not vary by location; they are spread identically across the country, as a percentage of property premiums. Costs are much higher than those in the United States, with French rates 6-24% of property premiums and US rates 3-8% of property premiums.

4. United Kingdom – Unlimited Government Credit to Private Pool

The UK government provides unlimited debt to a private reinsurance pool, which must repay any funds borrowed.

Since 1993, the UK has provided commercial property and business interruption insurance for terrorism acts (since 2002 extended to chemical, biological, and nuclear risks) through a mutual reinsurance organization called Pool Re. The UK Treasury provides unlimited credit to Pool Re, which is open to any private property insurers, but loans must be repaid in full to the government. Private insurers have an individual retention before being reimbursed by the pool, which is based on their proportional participation in Pool Re, applied to the "industry retention" (£100 million per event, £200 million per year in 2012). Pool Re must exhaust its reserves (currently £4.7 billion) before receiving any UK government assistance, and it shares 10% of its collected premiums with the UK government in exchange for coverage.

5. Germany – Government-Backed Private Insurance Company

The German government backs a private catastrophe insurance company.

Since 2002, the federally-backed property insurance corporation *Extremus AG* has provided catastrophe insurance for Germany, covering property and business interruption for total insured losses over 25 million euros. The annual compensation by *Extremus* for any company is capped at 1.5 Billion euros. Unlike Pool Re, *Extremus* is not a reinsurance institution but a private insurance company. It is reinsurance by both private reinsurance companies (first layer limited to 2 Billion euros), as well as by the federal government (second layer of 8 Billion euros). The annual capacity to pay claims is therefore 10 Billion euros. *Extremus* collects approximately 50 million euros in premiums and pays 12.5% of premiums to the federal government in exchange for coverage.

6. Netherlands – dedicated reinsurance company

The Dutch government backs a dedicated private reinsurance pool.

Since 2003, the Dutch Terrorism Risk Reinsurance Company (NHT) has provided catastrophe insurance as a dedicated reinsurance pool. The NHT has available market capacity of EUR 1 billion per calendar year, with EUR 400 million borne by the pool participants according to their market shares and the excess layer up to EUR 950 million placed on the international reinsurance market, with the Dutch government contributing EUR 50 million.

The above international review shows that different countries have responded to the question of terrorism risk financing differently, and that those responses were often modified after terrorist attacks on national soil. International benchmarks may be relevant for the United States as we rethink the role that TRIA should play in the future.